

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Developing a Unified Intercarrier	)	CC Docket No. 01-92
Compensation Regime	)	

**COMMENTS OF  
FOCAL COMMUNICATIONS CORPORATION,  
PAC-WEST TELECOMM, INC.,  
RCN TELECOM SERVICES, INC.  
AND US LEC CORP.**

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## SUMMARY

The proposals contemplated in the *Intercarrier Compensation NPRM* would fundamentally overhaul the regulations governing compensation for exchange of all types of traffic between carriers. The *NPRM* does not ask whether this would comport with the goal of regulatory certainty. To ask this question in this context is also to quite clearly answer it: no, the proposals in the *Intercarrier Compensation NPRM* would not promote regulatory certainty or a stable regulatory environment that would encourage the investment necessary for further development of local service competition. In fact, these proposals inherently involve new, dramatic uncertainties as to what business models would be appropriate or feasible in the new environment.

Moreover, the proposal in the *Intercarrier Compensation NPRM* to implement bill-and-keep for ISP-bound calls would send exactly the wrong message to investors in the competitive telecommunications industry. That message is that long-established rules are not safe from radical revision. The *Local Competition Order* established a level-playing field of mutual and reciprocal recovery of costs based on symmetrical rates. The *NPRM* proposes to change the rules because CLECs have succeeded in winning customers that generate more inbound than outbound traffic, and thus require ILECs to pay reciprocal compensation to CLECs. Although reciprocal compensation rates are required to reflect the ILECs' own costs, the *NPRM* speculates that determining such costs precisely is a practical impossibility, and concludes that some portion of the revenues received by CLECs may constitute arbitrage – or may not.

Without determining whether appreciable arbitrage exists any longer under the low rates currently ordered in state arbitration cases – or why arbitrage in any amount constitutes a policy concern rather than an ILEC revenue issue – the *NPRM* unveils solutions to this newly

discovered “problem.” The *NPRM* proposes a compensation scheme that will favor carriers with balanced traffic – typically ILECs – and that will effectively cancel the possibility that CLECs may serve specialized markets. The unspoken policy assumption of the *Intercarrier Compensation NPRM* is that only carriers with the traffic patterns and networks of ILECs should succeed. The proposals of the *Intercarrier Compensation NPRM* are thus profoundly at odds with the competitive goals of the Telecom Act.

The *Local Competition Order* made all of the correct decisions concerning implementation of the reciprocal compensation provisions of the Telecom Act. The framework established there -- if it is allowed to do so -- will solve the “problems” that the *Intercarrier Compensation NPRM* finds so troubling by encouraging ILECs to become more efficient in handling data traffic and to establish cost-based prices. This is the approach the Commission should embrace, not the anti-competitive proposals in the *Intercarrier Compensation NPRM*.

The *Intercarrier Compensation NPRM* is startling in that it contemplates fundamental changes on the basis of no more than two OPP Papers that themselves are in conflict as to how these changes should be implemented. For all the reasons described in the attached analysis by Economics and Technology, Inc., these conflicting papers do not present an adequate theoretical or empirical basis for moving forward with establishing bill-and-keep for any traffic. And even if bill-and-keep had merit from a purely academic perspective (and the two papers fail to make any such case), the practical and institutional problems involved in getting there from the present regulatory framework require that bill-and-keep as a serious proposal be abandoned.

The bill-and-keep proposals being considered would alter end user retail rates significantly, and would implicate federal-state jurisdictional concerns in ways that the

Commission has likely not encountered before. The regulatory changes that would be necessary for bill-and-keep, especially with respect to retail rates, many of which are beyond the Commission's jurisdiction, would be so complex and cumbersome as to make them unachievable as a practical matter. Even if they were achievable, the costs would outweigh the benefits, and the radical shifting of billions of dollars in cost-recovery from carriers to end users would be unprecedented. Such a radical revision to existing industry arrangements would require a realistically unachievable level of willingness on the part of the industry, the States, and consumers. The Commission must carefully assess whether the game is worth the candle, considering the so-called "problems" that the *NPRM* is trying to solve. Commission would far more successfully achieve its goals by retaining the current CPNP regime.

The problems that would be created by across-the board bill-and-keep are numerous and serious. In order to assure that dominant carriers would be able to recover costs from end users, and that any such charges are reasonable, the Commission would need to implement major new federal programs establishing additional federal end user charges. In this connection, the *Intercarrier Compensation NPRM* does not adequately consider the impact on any bill-and-keep regime of the newly created categorization of ISP-bound traffic as "information access." Under a bill-and-keep regime, in order to assure competitive neutrality, the Commission would need to assert federal jurisdiction over ILEC recovery of costs incurred in providing end users access to ISPs and set rates and rate structures for ILEC charges to end users for access to ISPs. These programs would be at least as complicated as existing regulation of exchange access and reciprocal compensation. Moreover, because charges to end users would be policed if at all only ineffectively by consumers instead of by other carriers, consumers would inevitably end up

paying more. In addition, as conceded by the OPP Papers, regulators would need to prescribe interconnection arrangements. The fact that these papers conflict on how this should be done is symptomatic of the problems inherent in bill-and-keep.

While moving to a unified scheme of bill-and-keep for all traffic would be unwise and unfounded, applying bill-and-keep to only a subset of traffic such as ISP-bound traffic would constitute even worse policy. First, any such limited implementation would be virtually impossible. The OPP Papers' analysis of the incentives and benefits in the adoption of bill-and-keep is unconvincing for the most part but does verify that CLECs could not satisfactorily operate a single network subject at the same time to CPNP and bill-and-keep. Second, the OPP Papers themselves urge bill-and-keep as a means to eliminate arbitrage among different forms of traffic. Limited implementation would increase the problem of arbitrage – since the potential gain would become greater – and not eliminate it. Third, limited implementation would quickly become a naked exercise in the regulatory selection of winners and losers: IXC's over ILEC's, ILEC's over CLEC's, etc.

The proposals in the *NPRM* to establish bill-and-keep as the basis for intercarrier compensation should be abandoned as both undesirable and unachievable in the real world.

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Focal Communications Corporation, Pac-West Telecomm, Inc., RCN Telecom Services, Inc., and US LEC Corp. (collectively “Commenters”) submit these comments in response to the *Intercarrier Compensation NPRM*<sup>1</sup> in which the Commission initiated a fundamental reexamination of all currently regulated forms of intercarrier compensation. For the reasons stated below, the Commission should not establish bill-and-keep as the required form of intercarrier compensation for any traffic.

**I. REGULATORY CERTAINTY SHOULD BE AN OVERARCHING GOAL GUIDING THE COMMISSION IN THIS PROCEEDING**

The *Intercarrier Compensation NPRM* appropriately starts with an inquiry as to what regulatory goals should guide the Commission’s decision-making in this proceeding.<sup>2</sup> While many goals are identified, including efficiency, making subsidies explicit, and avoidance of the

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<sup>1</sup> *Developing a Unified Intercarrier Compensation Regime*, Notice of Proposed Rulemaking, CC Docket No. 01-92, FCC 01-132, released April 27, 2001 (“*Intercarrier Compensation NPRM*” or “*NPRM*”).

need to allocate common costs, it is striking that regulatory certainty is absent from the analysis. And particularly so, since the Commission frequently cites regulatory certainty as an important goal.<sup>3</sup>

At the same time, it is not surprising that this goal was entirely omitted from the analysis. In the context of the proposals contained in the *Intercarrier Compensation NPRM*, that goal could not have been seriously raised. The proposals in the *NPRM* would not promote regulatory

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<sup>2</sup> *Intercarrier Compensation NPRM*, Section III, A.

<sup>3</sup> *The 2000 Biennial Regulatory Review*, FCC 00-456 (January 17, 2001) at ¶ 22 (“In [the CALLS] proceeding, we adopted a five-year plan that reduces access charges, rationalizes the access charge rate structure, and creates an explicit interstate access universal service support mechanism - providing regulatory certainty for the industry.”); *Principles for Promoting the Efficient Use of Spectrum by Encouraging the Development of Secondary Markets*, 15 FCC Rcd 24178 (December 01, 2000) ¶ 16 (“We hope that the planned initiatives discussed below will lead to greater regulatory certainty that will mitigate general resistance to resale or leasing.”); *Deployment of Wireline Services Offering Advanced Telecommunications Capability and Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 14 FCC Rcd 20912 (1999) ¶ 61 (“As we stated in the Local Competition Third Report and Order, we believe that revisiting our national network element unbundling rules in three years will provide carriers and capital markets the time and regulatory certainty they need to implement business plans.”); *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third Report and Order and Fourth Further Notice Of Proposed Rulemaking, 15 FCC Rcd 3696 (1999) ¶ 352 (“In establishing reasonable limitations and technical parameters for dark fiber, states should acknowledge that requesting carriers require regulatory certainty in order to implement their business plans.”); *1998 Biennial Regulatory Review Spectrum Aggregation Limits for Wireless Telecommunications Carriers; Cellular Telecommunications Industry Association's Petition for Forbearance From the 45 MHz CMRS Spectrum Cap; Amendment of Parts 20 and 24 of the Commission's Rules -- Broadband PCS Competitive Bidding and Commercial Mobile Radio Service Spectrum Cap; Implementation of Sections 3(n) and 332 of the Communications Act; Regulatory Treatment of Mobile Services*, Report and Order, 15 FCC Rcd 9219 (1999) ¶ 51 (“Providing regulatory certainty is particularly important in an environment in which there is likely to be widespread restructuring of CMRS spectrum holdings, for example, in apparent efforts to create national footprints or as the by-product of larger mergers within the telecommunications industry. We also agree with numerous commenters who assert that regulatory certainty is critical to providing the industry with incentives to make investments, including in new technologies such as 3G service.”)

certainty because they would fundamentally overhaul regulations governing not only compensation but interconnection as well.

Competitive local exchange carriers (“CLECs”) are presented with the prospect of losing revenue streams that have been established through the course of implementing the Telecommunications Act of 1996 (“Telecom Act”) over several years. CLECs have no assurance that those revenue streams could be recovered from end users to any extent, especially at the same time that CLECs would be required to establish new interconnection arrangements. If bill-and-keep were actually ordered, CLECs would have to start over in crafting and implementing business plans. To take merely one aspect of how problematic this transition would be, in the present economic environment it is not at all clear that the investment community would accept the impact on earnings (however short term) that could result from substantially revised business plans. Moreover, no one can predict with any certainty when the market will accept CLECs incurring the costs associated with the restructuring that a transition to bill-and-keep would entail. The Commission could not simply declare that bill-and-keep will be implemented at some future point with the proviso that the Commission will monitor and delay the date of implementation if necessary. CLECs would need to start making real world changes well in advance of any implementation date, and thus in effect would be required to sink or swim well before the actual implementation of bill-and-keep. Financial markets might refuse to provide significant support to CLECs given the uncertain impact of bill-and-keep. CLECs do not find it reassuring that this proceeding has been initiated on the basis of highly theoretical and diffuse examinations of “incentives” and “benefits,” which are inherently speculative, and on the

basis of two documents from the Office of Plans and Policy (“OPP Papers”) that conflict on everything other than high-level analysis.<sup>4</sup>

The fact that the *NPRM* did not evaluate regulatory certainty as a relevant factor that should inform decision-making renders the *Intercarrier Compensation NPRM* an inadequate basis for further consideration of bill-and-keep. In its deliberations, the Commission should fully consider the harmful impact this factor alone could have on the competitive industry and, in light of it, abandon further consideration of the proposals to turn the world upside down. This is all the more the only reasonable outcome of this proceeding because the “problems” cited in the *Intercarrier Compensation NPRM* can be solved merely by a more rigorous implementation of the existing “calling party’s network pays” (“CPNP”) framework. As explained in these comments, instead of essentially throwing out intercarrier compensation and starting over, the Commission should more thoroughly implement CPNP. For Section 251(b)(5) traffic and ISP-bound traffic, the Commission should maintain, and, to the extent necessary return to, the framework of the *Local Competition Order*.<sup>5</sup> For interstate exchange access traffic, the Commission likewise should assure that rates of ILECs are set on forward-looking costs.

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<sup>4</sup> Patrick DeGraba, “Bill-and-Keep at the Central Office as the Efficient Interconnection Regime,” OPP Working Paper No. 33 (December 2000) (“DeGraba”); Jay M. Atkinson and Christopher C. Barnekov, “A Competitively Neutral Approach to Network Interconnection,” OPP Working Paper No. 34 (December 2000) (“Atkinson/Barnekov”). DeGraba proposes an intercarrier compensation regime he calls “COBAK,” for “Central Office Bill-And-Keep.” Atkinson/Barnekov propose an intercarrier compensation regime they call “BASICS,” for “Bill Access to Subscriber, incremental Interconnection Costs Shared.”

<sup>5</sup> *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499 (1996), *vacated in part*, *Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *rev’d in part, aff’d in part*, *AT&T Corp. v. Iowa Utils. Bd.*, 119 S. Ct. 721 (1999) (“*Local Competition Order*”).

## **II. THE *ETI REPORT* DEMONSTRATES THAT THERE IS NO THEORETICAL OR RATIONAL BASIS FOR MOVING TOWARD BILL-AND-KEEP**

Commenters are submitting with these comments an economic analysis prepared by Economics and Technology, Inc. entitled “Efficient Inter-Carrier Compensation Mechanisms for the Emerging Competitive Environment” (“*ETI Report*”). The *ETI Report* identifies eight (8) core principles that any intercarrier compensation regime must follow. The Commission should reject proposals for intercarrier compensation regimes that cannot support these principles. A compensation arrangement should (1) stimulate efficient economic decisions; (2) be competitively neutral; (3) expressly recognize the potential for market diversity, innovation, and experimentation, and as such should not embrace, reflect, or impose any predisposition as to any one particular market outcome; (4) be comprehensive and consistent across all network functions having substantially similar economic and technical characteristics and costs; (5) to the extent possible, accommodate and harmonize with preexisting retail market pricing practices; (6) be relatively simple and straightforward; (7) be transparent to the end user; and (8) be maintained in place on an essentially permanent basis.<sup>6</sup> Viewed against these core principles, and for all the reasons expressed in the *ETI Report*, the *NPRM*’s bill-and-keep proposals should be rejected.

## **III. BILL-AND-KEEP WOULD REQUIRE MAJOR NEW REGULATORY PROGRAMS**

The key supposition of the *Inter-carrier Compensation NPRM* seems to be that bill-and-keep would significantly simplify both regulators’ oversight and carriers’ administration of

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<sup>6</sup> *ETI Report* at 18-19.

intercarrier compensation. In fact, bill-and-keep would be neither relatively simple and straightforward, nor consistent with preexisting retail market pricing practices. Bill-and-keep would require new, complex, and burdensome regulatory programs.

**A. Imposing Bill-and-Keep Would Result in Unprecedented Change**

The bill-and-keep proposals being considered would alter end user retail rates significantly, and would implicate federal-state jurisdictional concerns in ways that the Commission has likely not encountered before. The regulatory changes that would be necessary for bill-and-keep, especially with respect to retail rates, many of which are beyond the Commission's jurisdiction, would be so complex and cumbersome as to make them unachievable as a practical matter. Even if they were achievable, the costs would outweigh the benefits, and the radical shifting of billions of dollars in cost-recovery from carriers to end users would be unprecedented. Such a radical revision to existing industry arrangements would require a realistically unachievable level of willingness on the part of the industry, the States, and consumers. The Commission must carefully assess whether the game is worth the candle, considering the so-called "problems" that the *NPRM* is trying to solve. Commenters submit that the Commission would far more successfully achieve its goals by retaining the current CPNP regime.

**B. Bill-and-Keep Would Require an Overhaul of Federal End User Charges and Impose New Ones**

If bill-and-keep were adopted, the Commission would need to establish new incumbent local exchange carrier ("ILEC") federal end user charges, and closely regulate them in order to assure they are reasonable. These end user charges would include charges to recover ILEC costs that are currently recovered from interexchange carriers ("IXCs") in interstate exchange access

charges. States would not be responsible for assuring that ILECs' charges to end users to recover the costs of interstate exchange access are reasonable because these costs are jurisdictionally interstate. Even assuming states would choose to implement bill-and-keep for intrastate services, states will be unwilling to take responsibility for recovery of the costs of interstate exchange access by, for example, letting end-user recovery take the form of rate increases for local service. Therefore, under bill-and-keep the Commission would need to establish new federal end-user charges in order to permit ILECs to recover these costs and to assure that charges are reasonable.

The Commission currently has in place a complex scheme governing exchange access charges of ILECs that for several years has been the subject of various proceedings overhauling various rate level and rate structure requirements.<sup>7</sup> The unstated assumption of the *Intercarrier Compensation NPRM* that bill-and-keep would be deregulatory is invalidated by the enormous task of converting the interstate exchange access charge scheme into a program of federal end user charges. At a minimum this would entail all of the separations, accounting, and cost allocations involved in the current scheme, and might involve more complicated rules depending on how federal end-user charges were implemented. Moreover, the idea posited in the *NPRM* that bill-and-keep for exchange access would eliminate the need for allocation of common costs is erroneous.<sup>8</sup> An allocation of common costs would be involved in the development of end-user

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<sup>7</sup> *Access Charge Reform*, CC Docket 96-262, First Report and Order, 12 FCC Rcd 15982 (Access Charge Reform Order), *aff'd sub. nom. Southwest Bell v. FCC*, 153 F.3d 523 (8th Cir. 1998); *Pricing Flexibility Order & Notice*, 14 FCC Rcd 14221; *Access Charge Reform*, CC Docket No. 96-262, Sixth Report and Order, 15 FCC Rcd 12962 (2000) (CALLS Order).

<sup>8</sup> *Intercarrier Compensation NPRM* at ¶ 29, 34, 39.

charges to the same extent as currently employed in developing exchange access charges because the same costs are involved. The fact that the *NPRM* made this erroneous assumption demonstrates the inherent illogic in the bill-and-keep proposals. No one will be avoiding the “heavy lifting” of an allocation of common costs. Indeed, the bill-and-keep proposals under consideration would require not only the establishment

new federal end user charges with an allocation of common costs, but it would require numerous state commission rate cases to accomplish the same result on the state level. The Commission must carefully consider the implications of such a requirement.

Under the *NPRM* proposals, the Commission would also need to establish new and separate end user charges covering the ILEC’s cost of providing local exchange terminating service to Internet service providers (“ISPs”), which the Commission has determined – erroneously – constitutes “information access.”<sup>9</sup> Here, however, in contrast to the costs of interstate exchange access where the Commission would be creating and imposing a new category of charges on end users in addition to local service, the Commission would need to establish federal end user “information access” charges in order to remove them from current local service charges and preclude double recovery by the ILEC in an environment of bill-and-keep for ISP-bound traffic. As explained below, in a bill-and-keep environment ILECs would

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<sup>9</sup> *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, CC Dkt Nos. 96-98, 99-68, Order on Remand and Report and Order, FCC 01-131 (rel. Apr. 27, 2001) at ¶ 44 (“*ISP Traffic Remand Order*”). Focal, Pac-West, RCN, and US LEC have intervened in the appeal of the *ISP Traffic Remand Order* at the United States Court of Appeals for the District of Columbia Circuit. *WorldCom, Inc. v. FCC*, Dkt. 01-1218 (D.C. Cir.) The positions taken here by Focal, Pac-West, RCN, and US LEC are not to be construed as an acknowledgment by them of the lawfulness of the *ISP Traffic Remand Order*.

continue to recover the costs of paying reciprocal compensation to CLECs through the local rates charged to end users, even though the ILECs would no longer be paying reciprocal compensation, unless the Commission asserts jurisdiction over these “information access” costs and prohibits ILECs from continuing to recover them in local rates.

Further, this so-called “information access” provided by ILECs has an originating switching component, a terminating switching component, and a portion of local loop costs. This would entail a further allocation of common loop costs between interstate access and “information access.” Moreover, unless switching costs are imposed on a per-minute basis, end users that never access the Internet would be required to pay for information access they never use. If this information access charge were imposed on a per-minute basis, it would amount to the Internet tax that the Commission has vowed never to charge end users: “The bottom line is that the FCC has no intention of assessing per-minute charges on Internet traffic or changing the way consumers obtain and pay for access to the Internet.”<sup>10</sup>

While the complexity and difficulty of establishing these new end-user charges is daunting enough, these new end-user charges would create a certain firestorm of criticism from consumers. Consumers are not likely to readily understand or appreciate that the new federal end-user charges they must pay are appropriate because the government has determined that the “benefits” of being connected to the network are evenly shared between the calling and called party. End-user charges to recover the costs of information access charges would, as noted, make real the long standing specter of FCC-mandated charges to access the Internet. The

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<sup>10</sup> “No Consumer Per-Minute Charges to Access ISPs,” Fact Sheet, February 1999, available at [http://www.fcc.gov/Bureaus/Common\\_Carrier/Factsheets/nominute.html](http://www.fcc.gov/Bureaus/Common_Carrier/Factsheets/nominute.html).

Commission's experience in establishing the subscriber line charge ("SLC"), and headaches concerning pass-through of the primary interexchange carrier charge ("PICC"), would be mild in comparison to that of establishing major new federal end user charges recovering the costs of "information access." This consumer reaction alone proves the inadvisability of the proposals in the *Intercarrier Compensation NPRM*. Moreover, in addition, to new federal end-user charges, the Commission would need to engage in a wholesale re-regulation of IXC's to assure that they pass through to consumers the savings they experience in not paying interstate exchange access charges.

**C. Bill-and-Keep Would Require Entirely New Intrastate Retail Price Structures**

A fundamental element of the bill-and-keep proposals being considered is the elimination of a "calling party pays" or "sent paid" pricing model. Under a "sent paid" pricing model, the calling party's local service rates include the cost of originating switching, terminating switching, and interoffice transport for an average amount of outbound calls. Reciprocal compensation is the transfer of the terminating switching element of these rates to the carrier that actually provides the terminating switching. Under a bill-and-keep regime, the calling party would no longer be responsible for payment of the terminating switching function – those costs would be borne by the called party and included in the called party's local service rates.

Adopting a bill-and-keep regime would require every state commission to reexamine every ILEC local service tariff in order to reallocate the terminating switching function from the calling party's rates to the called party's rates. The *NPRM* does not adequately consider the magnitude of this enterprise, the costs associated with it, or whether any purported benefit from adopting bill-and-keep could possibly be worth the undertaking. As the *ETI Report* makes clear, neither

of the OPP Papers considers the impact on end-user retail rates of a bill-and-keep regime.<sup>11</sup> Of course, the fact that the Commission does not have the authority to set intrastate retail rates makes bill-and-keep totally impractical, and constitutes yet another reason why it should be abandoned.

**D. Bill-and-Keep Would Require Continued Regulatory Oversight of Interconnection**

Bill-and-keep would also require new programs prescribing and administering recovery of the costs of interconnection, as variously contemplated in the OPP Papers. In essence, the OPP Papers propose partially retaining the existing scheme of transport, although they would assign responsibility for these costs differently. Under COBAK, the originating LEC would be responsible for paying transport to the central office of the terminating LEC. Under BASICS, transport costs would purportedly be split, although in reality CLECs would pay more because they would be required under BASICS to interconnect with the ILEC in each ILEC-defined local calling area. Thus, for all practical purposes, bill-and-keep would require retention of regulation of ILEC-provided transport.<sup>12</sup> Therefore, bill-and-keep would require not only the establishment of new federal end user charges and the reallocation intrastate switching costs, but also the retention of major aspects of current programs. Accordingly, contrary to the assumptions in the *NPRM*, bill-and-keep would not be deregulatory but would require the establishment of sweeping new regulatory programs on top of existing ones.

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<sup>11</sup> *ETI Report* at 39-43.

<sup>12</sup> DeGraba at 30.

#### **IV. BILL-AND-KEEP WOULD NOT BE COMPETITIVELY NEUTRAL**

##### **A. Bill-And-Keep Favors Mature Carriers with Balanced Traffic**

In the *Local Competition Order*, the Commission determined that bill-and-keep was not appropriate, or consistent with Section 251(b)(5) of the Telecom Act, unless traffic was balanced because carriers would not be able to recover their costs of terminating traffic that originated on another carrier's network.<sup>13</sup> Therefore, establishing a bill-and-keep regime because ISP-bound traffic is unbalanced in favor of CLECs creates an intercarrier compensation scheme that will favor carriers with balanced traffic: while carriers with an overall balance of traffic will see little change to their net reciprocal compensation obligations, carriers with an imbalance will see a radical change as reciprocal compensation revenues will be eliminated and terminating costs will have to be recovered elsewhere. However, for the foreseeable future, only mature LECs can reasonably expect to have balanced traffic because only mature LECs have ubiquitous networks serving a sufficiently large customer base so that individual customer imbalances will cancel each other out in the aggregate. Therefore, the pricing scheme envisioned in the *Inter-carrier Compensation NPRM* is inherently discriminatory to new market entrants.

Although mature LECs have balanced traffic overall, there may be very few individual customers with balanced traffic patterns. Because a new market entrant lacks the facilities to serve all customers presently served by the ILEC, a traffic pattern that is perfectly "in balance" would be highly coincidental for the new competitive carrier.<sup>14</sup> The customers that the new

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<sup>13</sup> *Local Competition Order* at ¶ 1112 ("In general, we find that carriers incur costs in terminating traffic that are not *de minimis*, and consequently, bill-and-keep arrangements that lack any provisions for compensation do not provide for recovery of costs.")

<sup>14</sup> *ETI Report* at 9.

entrant serves must generate sufficient volumes of traffic to justify investment in facilities, whether inbound, outbound, or some mixture of both. In order to achieve a balance of traffic, the new entrant would need to find customers that offset any existing traffic imbalances, whether or not those customers reasonably fit within the carrier's mix of facilities and business model. Further, the new entrant potentially would need to deny service to a prospective customer if serving the customer would exacerbate existing traffic imbalances. A carrier faced with such a requirement may decide not to enter a particular market at all. As the *ETI Report* states, "[P]olicies that would work to promote such an outcome [i.e., balanced traffic patterns], or that would penalize CLECs for failing to become nothing more than smaller versions of the ILECs with which they seek to compete, are inherently anticompetitive and will work to discourage or block entry altogether."<sup>15</sup> Moreover, it would be unwise for a new market entrant to expect to be able to succeed as a scaled-down ILEC; in order to succeed against an entrenched monopoly provider, new entrants must be able "to innovate, specialize, and to target their service offerings to satisfy customer needs that may not be adequately met by the existing providers."<sup>16</sup> In essence, as explained in the *ETI Report*, bill-and-keep is a suitable arrangement only when the exchanged traffic will be roughly balanced, as is usually the case for non-overlapping, adjacent LECs. When the exchanged traffic primarily flows in one direction, which is more often the case than not for CLEC-ILEC interconnection, bill-and-keep is not appropriate because it will

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<sup>15</sup> *Id.* at 10.

<sup>16</sup> *Id.* at 9.

not result in equal in-kind compensation.<sup>17</sup> For these reasons, bill-and-keep would not be competitively neutral.

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<sup>17</sup> *Id.* at 9-10, 44.

**B. Recovery of Costs from End Users Would Favor ILECs**

As discussed above, it would be highly fortuitous if a carrier entering a market were to obtain a mix of customers that produced an overall balance of traffic exchanged with the ILEC. It is more likely, as has proven to be the case, that there will be an imbalance of traffic with the ILEC. New entrants that serve ISPs have more incoming traffic; other new entrants tend to have an imbalance of outbound traffic. ILECs, however, have ubiquitous networks extending to a wealth of end users in every category of traffic type. This disparate situation by itself provides a substantial advantage to ILECs in terms of the ability to recover costs from end users. Simply stated, ILECs will be in a better position than new entrants to recover their costs without raising end user rates because, in the aggregate, ILEC traffic is already roughly balanced. The average new entrant, on the other hand, will almost certainly have to raise rates to its end users in order to recover costs because high-volume inbound traffic customers represent a significantly larger percentage of its customer base. In addition, ILECs will more likely experience situations where both the calling party and the called party, in some cases, the ISP, are on the same network. Thus, these carriers will be receiving compensation both from the calling party and the called party. As new market entrants, CLECs will rarely experience this phenomenon, nor should they be expected to. Accordingly, recovery of terminating switching costs from end users would favor ILECs.

**C. Bill-And-Keep Would Create a Windfall for ILECs**

Bill-and-keep also would not be competitively neutral because it would create a windfall for ILECs. As recognized in the *Intercarrier Compensation NPRM*, ILECs currently recover

from their end users the reciprocal compensation payments they make to CLECs.<sup>18</sup> Obviously, under bill-and-keep, ILECs would no longer make those payments to CLECs, but they would still recover the revenues from end users to offset those costs until they lower their local rates. This excessive compensation would result in a windfall to the ILECs. This windfall would not be short-term, either. In order to make the necessary adjustments to end user rates, State commissions likely would have to complete elaborate cost analyses, including an allocation of common costs, to segregate the terminating switching and the “information access” elements from local rates. In the interim, ILECs would be beneficiaries of this lag in regulatory implementation.

CLECs, on the other hand, would immediately experience a reduction in payments from ILECs equal to the windfall ILECs would receive. Because CLECs would need to raise end user rates to recover this loss, while ILECs would have no apparent obligation to reduce any rates, bill-and-keep for ISP-bound traffic would not be competitively neutral.

It is also worth noting that consumers would be double-billed until the ILEC reduces local service charges in an environment of bill-and-keep.<sup>19</sup> Under bill-and-keep, the CLEC’s cost of terminating a call to an ISP would be passed on to the ISP, who in turn would pass the cost on to its customer, *i.e.* the calling party on the ILEC network. This calling party is already paying the costs of terminating the call to the ISP in the ILEC’s local service rates; the calling party would also be paying the costs of terminating the call as billed by the ISP.

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<sup>18</sup> *Intercarrier Compensation NPRM* at ¶ 37.

<sup>19</sup> *ETI Report* at 43.

**D. Dictating Points of Interconnection Based Upon Obsolete “Local Calling Areas” Would Discourage Competition and Market Entry.**

Under the COBAK and BASICS proposals for bill-and-keep that are being considered in the *Intercarrier Compensation NPRM*, CLECs would be required to rearrange their networks so that they have interconnection points within each ILEC-defined “local calling area.”<sup>20</sup> However, as pointed out in the *ETI Report*, the small “local calling areas” of the ILECs are an anachronism that is neither required nor appropriate in the contemporary telecommunications market.<sup>21</sup> It would make no sense for the Commission to now require carriers to establish interconnection arrangements on the basis of an essentially outmoded distinction between local traffic and toll traffic.<sup>22</sup>

The trend toward elimination of the distinction between local and toll services is already evident. To keep up with the competition, wireless carriers have all but abandoned the local/toll distinction in their service offerings.<sup>23</sup> This includes wireless carriers operated by the BOCs. Verizon boasts of its National and Regional “SingleRate” plans, while the SBC/BellSouth

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<sup>20</sup> *Intercarrier Compensation NPRM* at ¶23; *ETI Report* at 52.

<sup>21</sup> *ETI Report* at 52.

<sup>22</sup> *Id.* Commenters are not advocating elimination of LATA boundaries, however. LATA boundaries were created as part of the break-up of AT&T with the specific purpose of preventing Bell Operating Company (“BOC”) provision of long-distance services. Because LATA boundaries are necessary to help prevent violations of the federal antitrust laws by the BOCs (to the extent Section 271 authority is not improvidently granted), they must be retained and applied to BOC provision of telecommunications and information services until BOCs no longer have monopoly power.

<sup>23</sup> *See ETI Report* at 51.

Cingular venture offers “Cingular Nation” calling plans.<sup>24</sup> While there are several reasons why this practice has not yet reached the level of basic wireline service, chief among them is the lack of competition.

IntraLATA toll service provides a good example, and underscores the inadvisability of mandatory retention of the local/toll distinction. Every customer that switches to a competitive intraLATA toll provider is a customer that, at one point, has left the ILEC. A common ILEC response to this competitive loss is not to make its toll offerings more attractive, but to expand its local calling areas in order to convert toll traffic into local traffic in which it is the monopoly provider, thereby eliminating the intraLATA toll competition.<sup>25</sup> These practices of wireless carriers and ILECs further demonstrate that the local/toll distinction is now, or soon will be, obsolete.

It would not be competitively neutral to require CLECs to base their networks on soon-to-be-defunct ILEC call rating practices. By requiring interconnection with the ILEC in every ILEC-defined local calling area, COBAK would essentially require CLECs to construct imitation ILEC networks. This would have a sharply negative impact on the ability of CLECs to provide superior and specialized quality service. Instead, interconnection should be based on current engineering principles, rather than the design choices made by ILECs prior to competition.

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<sup>24</sup> See <http://www.verizonwireless.com> ; [http://www.cingular.com/cingular/products\\_services/local\\_plans](http://www.cingular.com/cingular/products_services/local_plans).

<sup>25</sup> *Petitions for Limited Modification of LATA Boundaries to Provide Expanded Local Calling Service (ELCS) at Various Locations*, Memorandum Opinion and Order, 12 FCC 10646, 10648 (1997) (“We note that granting an [expanded local calling service] petition removes the proposed route from the competitive interexchange market, and some LATA modifications could reduce the BOCs' incentive to open their own markets to competition pursuant to section 271 of the (con't.)

Permitting CLECs to innovate and deploy the most efficient technology available is essential to their ability to compete effectively against incumbents. Bill-and-keep would not be competitively neutral because it would thwart CLECs' ability to do so.

**V. BILL-AND-KEEP SHOULD NOT BE APPLIED SEPARATELY TO ISP-BOUND TRAFFIC**

**A. Singling Out ISP-bound Traffic for Bill-And-Keep Would Send The Wrong Message to Investors in the Competitive Industry**

The *Intercarrier Compensation NPRM* suggests that at the very least the Commission will mandate bill-and-keep for ISP-bound traffic.<sup>26</sup> It should be remembered that ILECs strongly opposed bill-and-keep not for any overarching policy reason but for the simple reason that they presumed that they would be terminating significantly more calls than the CLEC.<sup>27</sup> After winning on this point in the rules adopted in the *Local Competition Order*, the ILECs convinced states to adopt above-cost termination rates for reciprocal compensation.

What happened next is that the rules established in the *Local Competition Order* began to work exactly as everyone (but the ILECs) intended. Under those rules, rates for reciprocal compensation are based on ILEC rates, thus assuring ILECs that they will be compensated for calls they terminate.<sup>28</sup> CLECs received no such assurance and, in fact, faced the possibility that

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Act.” )

<sup>26</sup> *Intercarrier Compensation NPRM* at ¶ 66.

<sup>27</sup> Shira Levine, *Compensation*, America's Network at 2 (June 1, 2001).

<sup>28</sup> *Local Competition Order* at ¶¶ 1085-1093.

they would not be able to recover their high initial start-up costs for quite some time, which is still the case for most CLECs. The symmetrical reciprocal compensation rate based on ILEC costs provided an even-handed opportunity for both ILECs and CLECs to earn greater profits by becoming more efficient than what is implied in the ILEC rate.<sup>29</sup> ILECs could have chosen to provide data services using the most efficient network architecture. This, in turn would have enabled ILECs to earn greater profits for this traffic whether the call originated on their own network or on a CLEC network. This also would have translated into lower symmetrical rates governing the ILECs' payments to CLECs. ILECs chose not to provide service to ISPs in the most efficient manner allegedly because of concerns that data networks would be subject to unbundling, but more significantly because frank disclosure of underlying network costs would have revealed that their interstate access charges are inflated.

CLECs, on the other hand, chose to compete under the rules established in the *Local Competition Order*.<sup>30</sup> The ISP market was under-served by ILECs, and CLECs attracted this business by offering state-of-the-art local fiber networks, by meeting a demand for bandwidth

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<sup>29</sup> *ETI Report* at 19, n.29, 22-34. The *ETI Report* explains how the ILEC is the price leader for terminating switching services. Based upon the price set by the ILEC, CLECs would have the option to decide to be either net buyers of terminating switching from the ILEC, or net sellers of terminating switching to the ILEC. *Id.* at 27-29. In this respect, setting termination compensation rates at ILEC cost establishes an extremely efficient "I cut, you choose/You cut, I choose" economic negotiation. *Id.* Similarly, one can easily see how a terminating switching rate of zero – which is all that bill-and-keep amounts to when traffic is out of balance – would prompt a competitor to be a net purchaser of terminating switching from the ILEC (at no cost). If a competitor will terminate another carrier's traffic for free, the other carrier has every incentive to send that competitor as much traffic as it can. By these examples, it is plain to see that ILEC-based terminating compensation rates will stimulate efficient economic decisions, while bill-and-keep would not.

<sup>30</sup> *Local Competition Order* at ¶ 1103.

that ILECs underestimated, and by offering to collocate ISP equipment.<sup>31</sup> The gains did not come without cost, however, as CLECs made substantial investments in facilities to service their ISP customers. Moreover, it is also important to note that CLECs were effectively compelled to seek out ISPs as customers because the inflated termination rates established by the ILECs made it uneconomical for CLECs to have ILECs terminate significant amounts of traffic originating on CLEC networks.<sup>32</sup>

ILECs made a miscalculation in their approach to reciprocal compensation, to put it generously. After structuring the ground rules of reciprocal compensation to benefit themselves, the ILECs found that the system no longer worked as they had expected. Their solution was, and is, to change the rules they had advocated. The ILECs succeeded in having reciprocal compensation rates for ISP-bound traffic significantly reduced, in imposing growth caps on ISP-bound traffic eligible for reciprocal compensation, and in implementing bill-and-keep for ISP-bound traffic in new markets. Taking these ILEC gains one step further, the *NPRM* would abolish all intercarrier compensation for ISP-bound traffic. The Commission should not do so. This could signal investors that the Commission will protect ILECs from competition. Protecting ILECs from bad business choices is not the Commission's responsibility.<sup>33</sup> Instead,

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<sup>31</sup> Kasey Chappelle, *The End of the Beginning: Theories and Practical Aspects of Reciprocal Compensation for Internet Traffic*, 7 CommLaw Conspectus 393, 398 (1999) ("Chappelle").

<sup>32</sup> See note 29, *supra*.

<sup>33</sup> See TR Daily, "Powell Faults Industry's Inconsistent Regulatory Stance," March 24, 1999. See also *ETI Report* at 20:

In dictating the reciprocal compensation rate that would apply for interchanged local  
(con't.)

the Commission should make clear that ILECs can reduce reciprocal compensation rates, and thereby lower their payment obligations, by revealing their true costs and by becoming more efficient as intended by the *Local Competition Order*.

**B. Singling Out ISP-Bound Traffic for Bill-And-Keep Would Demonstrate that There is No Valid Economic Basis for Bill-And-Keep**

If there is any theoretical basis for establishing bill-and-keep, those considerations require that the Commission establish bill-and-keep for all traffic, not just for ISP-bound traffic. Neither of the OPP Papers distinguishes ISP-bound traffic from other types of traffic. Indeed, the OPP Papers would treat all traffic -- intrastate and interstate, ISP-bound and non-ISP-bound - the same. Establishing bill-and-keep only for ISP-bound traffic would verify that the theoretical underpinnings discussed in the *Intercarrier Compensation NPRM* and the OPP Papers are unconvincing. If these theories had any validity, the Commission would establish bill-and-keep for all traffic.<sup>34</sup>

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traffic, ILECs confronted CLECs with what amounted to a straightforward business decision as to whether the CLECs should be buyers of call termination services from the ILECs, or sellers of call termination services to the ILECs. Because CLECs were faced with much higher reciprocal compensation rates than the CLECs themselves had proposed in negotiations (and which, despite ILEC claims at the time, now appear to have been set decidedly in excess of cost), some CLECs elected to “sell” rather than to “buy” at that price, and solicited customers (including ISPs) with relatively high inward calling requirements. Thus, ILECs lost the opportunity to serve these high-volume call termination customers by mispricing their services. *It would be entirely inappropriate at this time to now engage in what amounts to nothing short of a bail-out of those ILEC errors.* In competitive markets, competitors live or die by their own business judgments and decisions, *and it is not the role of regulators to backstop these market choices by after-the-fact protective measures.*

<sup>34</sup> Adopting a bill-and-keep regime for ISP-bound traffic prior to adopting the same for all traffic – which, of course, the Commission should not and may not do – would make as much sense as the solution in this anecdote repeated in the *ETI Report*:

There is a parable (the source of which is Professor Alfred Kahn, former Chairman of the  
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**C. There Is No Operational or Cost Difference Between Voice and Data Traffic**

With respect to local voice and ISP-bound traffic, the Commission has already determined that there is no basis for treating this traffic differently. In the *ISP Traffic Remand Order* the Commission concluded:

we see no reason to impose different rates for ISP-bound and voice traffic. The record developed in response to the *Intercarrier Compensation NPRM* and the *Public Notice* fails to establish any inherent differences between the costs on any one network of delivering a voice call to a local end-user and a data call to an ISP. Assuming the two calls have otherwise identical characteristics (*e.g.*, duration and time of day), a LEC generally will incur the same costs when delivering a call to a local end-user as it does delivering a call to an ISP. We therefore are unwilling to take any action that results in the establishment of separate intercarrier compensation rates, terms, and conditions for local voice and ISP-bound traffic.<sup>35</sup>

Similarly, exchange access traffic also uses the network transport and termination functions used for local voice and ISP-bound calls.<sup>36</sup> Therefore, establishing bill-and-keep only for ISP-bound traffic would contradict the Commission's determination that there is no basis to distinguish between voice and data traffic for purposes of reciprocal compensation.

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New York Public Service Commission) about a debate that once took place in the Irish Parliament about converting from driving on the left (as in the UK) to driving on the right (as in the rest of Europe and in the US). The debate raged on, until one back-bencher, in an attempt at compromise, suggested that the conversion be done on a transitional basis, starting only with trucks.

*ETI Report* at 42. As stated in the *ETI Report*, "Proposals, such as those being advanced in the Intercarrier Compensation NPRM, for a partial transition to bill-and-keep or 'shared responsibility' pricing will lead to an outcome that is no less chaotic." *Id.* at 43.

<sup>35</sup> *ISP Traffic Remand Order* at ¶ 90.

<sup>36</sup> *Id.* at ¶ 90, n. 180.

**D. It Would Be Particularly Favorable To ILECs To Apply Bill-And-Keep To ISP-Bound Traffic Alone**

As demonstrated, bill-and-keep for all traffic would not be competitively neutral for a number of reasons. Establishing bill-and-keep only for ISP-bound traffic would favor ILECs to an even greater degree and would represent a choice to protect ILECs. New market entrants acted in reliance on the rules established in the *Local Competition Order* and made the investment in facilities that enabled them to service ISPs effectively.

Moreover, the Commission has already recognized that this result would be unfair. In the *ISP Traffic Remand Order*, the Commission stated that if the “mirroring” rule were not maintained, there could be a significant spread between the reciprocal compensation rates paid to ILECs for Section 251(b)(5) traffic and the intercarrier compensation rate of zero paid to CLECs for terminating ISP-bound traffic. ILECs would be able to receive reciprocal compensation and reap the benefits of terminating traffic balanced in their favor. The Commission stated:

It would be unwise as a policy matter, and patently unfair, to allow incumbent LECs to benefit from reduced intercarrier compensation rates for ISP-bound traffic, with respect to which they are net payors, while permitting them to exchange traffic at state reciprocal compensation rates, which are much higher than the caps we adopt here, when the traffic imbalance is reversed. Because we are concerned about the superior bargaining power of incumbent LECs, we will not allow them to “pick and choose” intercarrier compensation regimes, depending on the nature of the traffic exchanged with another carrier. The rate caps for ISP-bound traffic that we adopt here apply, therefore, *only* if an incumbent LEC offers to exchange all traffic subject to section 251(b)(5) at the same rate. Thus, if the applicable rate cap is \$.0010/mou, the ILEC must offer to exchange section 251(b)(5) traffic at that same rate. Similarly, if an ILEC wishes to continue to exchange ISP-bound traffic on a bill and keep basis in a state that has ordered bill and keep, it must offer to exchange all section 251(b)(5) traffic on a bill and keep basis.<sup>37</sup>

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<sup>37</sup> *Id.* at ¶ 88.

This fairness policy is a sound one and it requires that bill-and-keep not be imposed on ISP-bound traffic alone, even if this were lawful.

**VI. BILL-AND-KEEP SHOULD NOT, AND MAY NOT, BE ADOPTED FOR ANY TYPE OF TRAFFIC**

**A. Bill-and-Keep Would Assure ILEC Dominance in Provision of Dial-up Service to ISPs**

As already noted, ILECs will experience a windfall as a result of imposing a bill-and-keep scheme for the transport and termination of ISP-bound traffic. ILECs would no longer be required to make reciprocal compensation payments to CLECs, but would continue to recover in local service rates the costs of making those reciprocal compensation payments. Absent an extensive assertion of federal authority over so-called “information access” traffic, ILECs in all likelihood will have no need to raise rates to ISPs, and may in fact consider reducing them, even temporarily, in order to reclaim ISP market share. On the other hand, rather than having a choice of whether to reduce rates, CLECs would need to decide where to increase rates because reciprocal compensation for ISP-bound traffic would be eliminated.

If a CLEC must recover terminating switching costs from its ISP customer, it is axiomatic that the rates to the ISP will increase. This means ISPs will either absorb the increased rates into their operating costs and reduce profits, or they will raise rates to their end users. The former will impair the ability to attract and maintain investment, so the latter is far more likely to occur. If bill-and-keep is imposed on the exchange of traffic to ISPs, ISP rates to their subscribers will necessarily increase, at least for ISPs served by CLECs.

The fact that the ISP must increase its own rates to its end user customers means that ISPs served by CLECs may be less competitive than ISPs served by ILECs who could potentially pass through to their own customers any rate reductions implemented by ILECs. In

this environment, ISPs are likely to migrate from CLECs to ILECs. The Commenters submit, therefore, that bill-and-keep will assure that ILECs will be the dominant providers of dial-up service to ISPs.

**B. Bill-and-Keep Will Impair the Ability of ISPs to Obtain High-Quality Connections to the Public Switched Network**

Precluding any compensation for termination of ISP-bound traffic will have a significant impact on the ability of ISPs to connect to the public switched telephone network. As one commenter has noted:

A clear compensation regime is necessary for ISPs to connect to the PSTN. Without it, carriers have no incentive to carry the traffic or to upgrade their networks to accommodate it, in direct contradiction to the stated goals of the 1996 Act. However, the FCC has already declared that internet traffic is exempt from access charges. If carriers are precluded from reciprocal compensation for ISP traffic at this time, they will have little reason to solicit ISP customers or to upgrade their networks to carry data traffic. Not only will removing this source of CLEC revenue impede competition, but because the internet has flourished under a flat rate payment structure, a change in payment methods at this time may damage the development of the internet as a viable medium.<sup>38</sup>

The Telecom Act was designed to provide for a “pro-competitive, deregulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition.”<sup>39</sup> The role of CLECs in the burgeoning development of the Internet since the enactment of the Telecom Act should not be underestimated. As one observer notes:

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<sup>38</sup> *Chappelle* at 405.

<sup>39</sup> Telecom Act, S. Conf. Rep. 104-230 at 1 (1996).

Because of the reciprocal compensation arrangement, CLECs were willing to court ISP traffic by investing in upgrade of the basic, copper-wire network with fiber-optics. A significant obstacle to internet development is the lack of efficient and affordable high-quality networks and connections, an obstacle the CLECs were working to remedy. Taking away a source of income related to carriage of ISP traffic will reduce motivation to carry the traffic and to upgrade the network. This would be contradictory to Congress's concern about the availability of advanced services.<sup>40</sup>

It should also be noted that CLECs stepped in to serve ISPs when dial-up Internet access exploded following adoption of flat-rate pricing by ISPs. In contrast, the ILECs complained to the Commission about the enormous burden that ISPs were imposing on their networks and the network upgrades that were required.<sup>41</sup> One reasonably could have assumed that ILECs would have been pleased to have CLECs handle the transport and termination of traffic to ISPs. Imposing bill-and-keep for ISP-bound traffic now would undo those competitive market dynamics and either force CLECs to stop servicing ISPs or require much higher rates for ISPs. Either scenario will have a detrimental impact on access to the Internet.

In fact, continuing to allow the recovery of the costs of providing service to ISPs through reciprocal compensation is most likely to permit provision of the highest quality service to ISPs. As has been observed:

The structure of reciprocal compensation is more suited to the carriage of ISP traffic than the structure of access charges, if the stated goals of promoting use of advanced services and the internet are to be accomplished. Because those goals

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<sup>40</sup> *Chappelle* at 407.

<sup>41</sup> *ETI Report* at 33-34. As the *ETI Report* explains, several BOCs submitted cost studies to the Commission in connection with Commission's inquiry into the usage of the public switched network by ISPs (CC Docket No. 96-263). Although the cost studies were flawed, they actually showed that the BOC's avoided costs for termination of ISP-bound traffic were higher than a rates based solely on the BOC's forward-looking economic cost for terminating all traffic. *Id.* at 34.

can best be achieved by maintaining a flat-rate payment structure for ISP use, reciprocal compensation, used for other flat-rate calls, is more suitable. Until a way is found to fit the current regulatory structure to the converging telecommunications market, reciprocal compensation should be retained.<sup>42</sup>

Accordingly, bill-and-keep should not be imposed on ISP-bound traffic because this would impair the ability of ISPs to obtain the highest quality service.

**C. The Commission May Not Establish Bill-and-Keep for Non-ISP Local Traffic Under Section 251(b)(5)**

Even if one assumes that the *ISP Traffic Remand Order* correctly segregates ISP-bound traffic from non-ISP-bound traffic (which the Commenters do not believe was legally correct), the Commission does not have the authority to impose bill-and-keep on non-ISP-bound traffic. The Commission's authority to implement a unified bill-and-keep regime for non-ISP local traffic is limited by the statutory language of the Telecom Act. Section 251(b)(5) of the Telecom Act places on local exchange carriers the duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications.<sup>43</sup> Section 252(d)(2)(A) states that for terms and conditions for reciprocal compensation to be just and reasonable they must provide for "the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of

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<sup>42</sup> *Chappelle* at 405.

<sup>43</sup> 47 U.S.C. § 251(b)(5).

the other carrier.”<sup>44</sup> In addition, the costs must be determined on the basis of the “additional costs of terminating such calls.”<sup>45</sup>

While Section 252(d)(2)(B)(i) does not preclude use of arrangements such as bill-and-keep, the section states that the Telecom Act does not intend to “preclude arrangements that include the *mutual recovery of costs* . . . .”<sup>46</sup> The Commission currently allows states to impose bill-and-keep arrangements if “neither carrier has rebutted the presumption of symmetrical rates and if the volume of terminating traffic that originates on one network and terminates on another network is approximately equal to the volume of terminating traffic flowing in the opposite direction, and is expected to remain so . . . .”<sup>47</sup> In interpreting the requirements of Section 252(d)(2)(A)(i) in the *Local Competition Order*, the Commission concluded:

[I]n general, we find that carriers incur costs in terminating traffic that are not *de minimis*, and consequently, bill-and-keep arrangements that lack any provisions for compensation do not provide for recovery of costs. In addition, as long as the cost of terminating traffic is positive, bill-and-keep arrangements are not economically efficient because they distort carriers’ incentives, encouraging them to overuse competing carriers’ termination facilities by seeking customers that primarily originate traffic. On the other hand, when states impose symmetrical rates for the termination of traffic, payments from one carrier to the other can be expected to be offset by payments in the opposite direction when traffic from one network to the other is approximately balanced with traffic flowing in the other direction.<sup>48</sup>

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<sup>44</sup> 47 U.S.C. § 252(d)(2)(A).

<sup>45</sup> 47 U.S.C. § 252(d)(2)(A)(ii).

<sup>46</sup> 47 U.S.C. § 252(d)(2)(B)(i) (emphasis added).

<sup>47</sup> *Local Competition Order* at ¶ 1111.

<sup>48</sup> *Local Competition Order* at ¶ 1112.

The Commission correctly concluded that the relevant inquiry is whether a bill-and-keep arrangement would afford the mutual recovery of costs for both carriers. If it does not, the arrangement would be statutorily proscribed.

The bill-and-keep proposals in the *NPRM* would not afford the mutual recovery of costs because they would not provide for compensation when there are traffic imbalances. Such arrangements would not allow a LEC to recover its costs of termination where that LEC terminates more traffic than it originates.<sup>49</sup> Traffic imbalances are not limited to the exchange of ISP-bound traffic. As stated above, it would be highly unlikely for a new market entrant to have a balanced exchange of traffic with the incumbent, given its smaller customer base. There would not be a mutual recovery of costs as one LEC would not be compensated fully for its costs of terminating traffic. In effect the terminating LEC in an unbalanced exchange of traffic would be subsidizing the transport and termination costs of the originating LEC. In fact, as the Commission noted in the *Local Competition Order*, it provides a perverse incentive to the other LEC by “encouraging them to overuse competing carriers’ termination facilities by seeking customers that primarily originate traffic.”<sup>50</sup>

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<sup>49</sup> NARUC expresses concern about whether bill-and-keep will “provide fair compensation to each carrier in the market, especially if there are imbalances in the type or volume of traffic between the carriers.” *July 18, 2001 Resolution of the National Association of Regulatory Utility Commissioners Regarding the Development of a Unified “Bill-and-Keep” Intercarrier Compensation Regime*. (“*NARUC July 18 Intercarrier Compensation Resolution*”); see also, CC Docket No. 96-98, Comments of BellSouth Corporation at 3 (May 16, 1996); CC Docket No. 96-98, Comments of GTE Service Corporation at 55 (May 16, 1996).

<sup>50</sup> *Local Competition Order* at ¶ 1112; see also, CC Docket Nos. 96-98 and 99-68, *Ex Parte Letter of Time Warner Telecom to Secretary, FCC* at 5 (Oct. 20, 2000) (“*Time Warner Ex Parte*”); see also, *NARUC July 18<sup>th</sup> Intercarrier Compensation Resolution* (Bill-and-keep may “create perverse incentives regarding infrastructure development, network configuration, or  
(con’t.)

In fact, while the Commission allowed states to adopt bill-and-keep arrangements, the Commission directed states to “either include provisions that impose compensation obligations if traffic becomes significantly out of balance or permit any party to request that the state commission impose such compensation obligations . . . .”<sup>51</sup> Thus, the Commission clearly, and correctly, evidenced its conclusion that bill-and-keep arrangements are only appropriate when traffic is balanced, or as we shall show below, if the parties voluntarily agree to such an arrangement. This is the approach that comports most with the statutory language.

Unless traffic flow is balanced, a bill-and-keep arrangement would not provide for the mutual recovery of costs nor would it provide “a reasonable approximation of the additional costs of terminating such calls” as required by Section 252(d)(2)(A)(ii).<sup>52</sup> Even proponents of a “bill-and-keep” approach in the *Local Competition Proceeding* acknowledged that such an approach is problematic if traffic is not balanced.<sup>53</sup> The Commission recognized claims that bill-and-keep arrangements fail to adequately deal with each carrier’s costs, but noted that “by allowing carriers to rebut a presumption of balanced traffic volumes, the concerns that bill-and-keep arrangements fail to adequately deal with each carrier’s costs are addressed.”<sup>54</sup> By removing this protection, the Commission will preclude adequate cost recovery and contravene the requirements of Section 252.

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points of interconnection.”)

<sup>51</sup> *Local Competition Order* at ¶ 1113.

<sup>52</sup> *GTE Local Competition Comments* at 55.

<sup>53</sup> *Local Competition Order* at ¶ 1103.

<sup>54</sup> *Id.* at ¶ 1115.

The only situations where bill-and-keep arrangements should be allowed in the face of traffic imbalance is where the parties voluntarily agree to such an arrangement.<sup>55</sup> This is supported by the language in Section 252(d)(2)(B)(i) which states that that Section does not preclude “arrangements that *waive* mutual recovery (such as bill and keep arrangements.)”<sup>56</sup> The only parties that could waive a right to mutual recovery of costs are the parties that are exchanging the traffic. For a party to waive a claim or right, the party must “give up the right or claim voluntarily.”<sup>57</sup> The Commission cannot waive the right for the parties. This approach is also the most reasonable as the parties are in the best position to know if bill-and-keep is conducive to their traffic patterns. Even if the traffic is not in balance, a party on the short end of the traffic flow may still waive its right for mutual recovery for a *quid pro quo*. The Commission, under the language of the statute, cannot and should not waive the right for the parties. Thus, for a bill-and-keep regime to be statutorily permissible it must either afford the mutual recovery of costs or be invoked pursuant to a voluntary arrangement between the parties.

Implementation of a bill-and-keep approach also threatens to run afoul of the division of federal and state jurisdiction as redefined in the Telecom Act, and as interpreted by the Supreme Court. While the reciprocal compensation provisions are parts of Sections 251 and 252 of the Telecom Act, and the Commission has broad authority to implement regulations to carry out the provisions of these sections, in establishing bill-and-keep the Commission would be going

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<sup>55</sup> See *BellSouth Local Competition Comments* at 4 (“[u]nder the express language of the Act, bill-and-keep arrangements are only permissible where the parties voluntarily agree to waive mutual recovery of costs.”)

<sup>56</sup> 47 U.S.C. § 252(d)(2)(B)(i) (emphasis added).

beyond the limits placed on this authority by the Court.<sup>58</sup> Section 252(c)(2) entrusts the task of establishing rates to the state commissions. The Supreme Court held that this means that states “will apply those standards and implement that methodology, determining the concrete result in particular circumstances. That is enough to constitute the establishment of rates.”<sup>59</sup> A bill-and-keep regime would take the task of the actual setting of rates out of the hands of the state commissions. A bill-and-keep arrangement will set the termination rates for traffic at zero, and the states would be removed from this role. The Commission’s recent order on ISP-bound traffic is already being challenged by the National Association of Regulatory Utility Commissioners (“NARUC”) because it displaces reciprocal compensation rates for local traffic already established by state commissions.<sup>60</sup>

**D. The Commission May Not Establish Bill-and-Keep for ISP-Bound Traffic**

The Commission’s determination in its *ISP Traffic Remand Order* that ISP-bound traffic is “information access” under Section 251(g) and, therefore, not within the scope of Section 251(b)(5), is erroneous and does not provide a basis to support a bill-and-keep regime for ISP-

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<sup>57</sup> *Black’s Law Dictionary* 1580 (6<sup>th</sup> ed. 1990).

<sup>58</sup> *AT&T Corp. v. Iowa Utils. Bd.*, 119 S. Ct. 721, 730-733 (1999).

<sup>59</sup> *Id.* at 732.

<sup>60</sup> *July 18, 2001 National Association of Regulatory Utility Commissioners Resolution on Jurisdictional Issues for Internet-Bound Traffic* (“NARUC July 18<sup>th</sup> Reciprocal Compensation Resolution”). Limiting bill-and-keep to ISP-bound traffic would not be a solution since it would create an asymmetry in rates that would undercut the purported economic efficiency of bill-and-keep arrangements and create a potential for regulatory arbitrage.

bound traffic.<sup>61</sup> The Commission's legal error on this issue is the subject of the appeal of the *ISP Traffic Remand Order* before the United States Court of Appeals for the District of Columbia Circuit.<sup>62</sup> The Commenters have intervened in that appeal.

Quite simply, section 251(g) of the Telecom Act does not provide the broad statutory or jurisdictional authority that the Commission perceives in it. The Commission's reasoning is similar to an argument raised by Ameritech in an attempt to avoid paying reciprocal compensation for ISP-bound calls in a case before the U.S. District Court for the Northern District of Illinois.<sup>63</sup> Ameritech invoked section 251(g) in arguing that "because no court order, consent decree, regulation, order or policy of the FCC provided for payment of reciprocal compensation prior to February 7, 1996, reciprocal compensation cannot now apply [for ISP-bound traffic]." <sup>64</sup> The court found the argument to be "circular" noting:

Section 251(g) merely provides that local exchange carriers must provide services with the same "equal access and nondiscriminatory interconnection restrictions and obligations" as prior to the passage of the Telecommunications Act of 1996. As this court has found that the FCC has no prior ruling that controls in the instant case, there is no ruling that possibly could be violated by ordering continued payments of reciprocal compensation by the plaintiff.<sup>65</sup>

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<sup>61</sup> See, Shira Levine, *Compensation, America's Network* (June 1, 2001) (Quoting General Counsel for NARUC who believes that "the FCC's 'information access' case will be an easy target" and terming the rationale "the most vulnerable rationale I've seen.").

<sup>62</sup> See note 9, *supra*.

<sup>63</sup> *Illinois Bell Tel. Co. v. WorldCom Technologies, Inc.*, 1998 WL 419493 (N.D.Ill. 1998), *aff'd* 179 F.3d 566 (7th Cir. 1999), *cert. granted on other issues sub nom Mathias v. WorldCom Technologies, Inc.*, Dkt. No. 00-878.

<sup>64</sup> *Illinois Bell*, 1998 WL 419493, \*15.

<sup>65</sup> *Id.*

Thus, Section 251(g) merely preserves the status quo in regard to access services at the time of the enactment of the Telecom Act pending further action by the Commission,<sup>66</sup> and the Commission must validly determine that treating ISP-bound traffic as information access was part of this “pre-existing regulatory treatment.”

In *People of the State of California v. FCC*,<sup>67</sup> the Commission attempted to use Section 251(g) as a basis for its authority to promulgate intraLATA dialing parity rules. The Commission contended that the 1982 AT&T consent decree contained intraLATA dialing parity requirements. The Eighth Circuit noted that while the consent decree did speak to the issue of intraLATA dialing parity, the decree did not establish any specific intraLATA dialing parity rules.<sup>68</sup> The FCC conceded that Section 251(g) contained no reference to dialing parity and merely preserved the existing dialing parity requirements already imposed on incumbent LECs. The Eighth Circuit, therefore, declined to find that Section 251(g) provided a substantive basis for the rules the Commission sought to implement. Thus, the Commission already has been instructed not to invoke Section 251(g) in order to support new rules when there is otherwise no support for them elsewhere in the Telecom Act.

The conclusion that ISP-traffic is “information access” also does not follow from Commission precedent. As former Commissioner Furchtgott-Roth noted in his dissent to the *ISP*

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<sup>66</sup> *ISP Traffic Remand Order* at ¶ 38.

<sup>67</sup> 124 F.3d 934 (8<sup>th</sup> Cir. 1997), *rev’d in part on other grounds*, *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366 (1999).

<sup>68</sup> *Id.* at 941.

*Traffic Remand Order*, the “information access” approach is a complete reversal of Commission precedent in the *Advanced Services Remand Order*:

Among other things, the Commission [in the *Advanced Services Remand Order*] found meritless the argument that section 251(g) exempts ‘information access’ traffic from other requirements of section 251. Rather, the Commission explained, ‘this provision is merely a continuation of the equal access and nondiscrimination provisions of the Consent Decree until superseded by subsequent regulations of the Commission.’ According to the Commission, section 251(g) ‘is a transitional enforcement mechanism that obligates the incumbent LECs to continue to abide by equal access and nondiscriminatory interconnection requirements of the MFJ.’ The Commission thus concluded that section 251(g) was not intended to exempt xDSL traffic from section 251's other provisions.<sup>69</sup>

Commissioner Furchtgott-Roth went on to note that when the *Advanced Services Order* was appealed to the D.C. Circuit:

The Commission argued to the court in February that the term ‘information access’ is merely ‘a holdover term from the MFJ, which the 1996 Act supersedes.’ [WorldCom, Inc. v. FCC, Brief for Respondents at 50 (D.C. Cir. No. 00-1002)] Its brief also emphasized that section 251(g) was ‘designed simply to establish a transition from the MFJ's equal access and nondiscrimination provisions ... to the new obligations set out in the statute.’ Today, just two months after it made those arguments to the D.C. Circuit, the Commission reverses itself. It now says that section 251(g) exempts certain categories of traffic, including ‘information access,’ entirely from the requirements of section 251(b)(5) and that ISP-bound traffic is ‘information access.’ The Commission provides nary a word to explain this reversal.<sup>70</sup>

As Commissioner Furchtgott-Roth concluded, the Commission has done an about-face from its position that Section 251(g) serves only to “preserve the LECs’ existing equal access

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<sup>69</sup> *ISP Traffic Remand Order*, Dissenting Statement of Commissioner Furchtgott-Roth at 172. (“*Furchtgott-Roth Dissenting Statement*”).

<sup>70</sup> *Id.*

obligations, originally imposed by the MFJ” and instead “transforms Section 251(g) into a categorical exemption for certain traffic from Section 251(b)(5).”<sup>71</sup>

The Commission also failed to provide on remand any explanations, much less satisfactory ones, to the central questions the court wanted answered, *i.e.*, why LECs that terminate calls to ISPs are not properly seen as “terminat[ing] local telecommunications traffic” and why such traffic is not “telephone exchange service.”<sup>72</sup> As Commissioner Furchtgott-Roth noted “the Commission would act far more responsibly if it simply recognized that ISP-bound traffic comes within Section 251(b)(5).”<sup>73</sup> While such an approach would limit its ability to impose bill-and-keep for ISP-bound traffic for the reasons described above for non-ISP-bound traffic, the Commission could still issue “rules to guide the state-commission judgments” regarding reciprocal compensation.<sup>74</sup>

Accordingly, the Commission erred in determining that ISP-bound calls constitute “information access” and it may not establish bill-and-keep for this traffic any more than for local voice traffic because ISP-bound traffic is subject to Section 251(b)(5).

## **VII. BILL-AND-KEEP SHOULD NOT BE APPLIED TO ACCESS TRAFFIC**

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<sup>71</sup> *Id.*

<sup>72</sup> *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1, 9 (D.C. Cir. 2000).

<sup>73</sup> *Furchtgott-Roth Dissenting Statement* at 167.

<sup>74</sup> *Id.* at 167.

**A. Bill-and-Keep for Interstate Exchange Access Would Require a New Federal Regulatory Program that Would Increase End-User Rates**

As noted, bill-and-keep for interstate exchange access would result in new federal end-user charges because ILECs would need to recover the costs of providing interstate exchange access from their end users instead of from IXC. There is no doubt that the Commission would need to regulate these end user charges. As the Commission knows, competitive alternatives to ILEC local service are not ubiquitously available. Although CLECs have won market share, ILECs still serve over 91% of local access lines and over 95% of residential and small business access lines.<sup>75</sup> Moreover, shifting cost recovery from IXCs to end users would require a massive upheaval in consumer pricing. Even if the Commission could be assured that the LEC would see no net increase in access charge revenue as a result of bill-and-keep, the simple act of putting those charges in end user retail rates – in all 50 states – would require an enormous level of cooperation among States, consumers, LECs, and IXCs.

Furthermore, as also noted, even under the COBAK and BASICS proposals, ILECs will continue to charge most IXCs for some form of transport. Thus, in addition to adopting new rules for the access charges moved to end users, the Commission will have to maintain its regulations for access charges that ILECs will still impose on IXCs. In short, bill-and-keep for interstate exchange access charges will result in more, not less, federal regulation.

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<sup>75</sup> Industry Analysis Division, *Local Competition: Status as of December 31, 2000* (May 2001).

**B. Flat-Rated End User Charges Would be Inefficient**

The Commission has historically tried to set rates that reflect the manner in which costs are incurred. The *Intercarrier Compensation NPRM* asks whether the end-user charges that replace usage-sensitive carrier's carrier charges should be flat-rated.<sup>76</sup> In 1983, the Commission found that:

Provision of telephone services involves two marginal costs. One varies with the traffic level. The other varies with the number of access lines demanded. For this reason, efficient pricing requires both usage sensitive and non-usage sensitive charges for recovery of access costs.<sup>77</sup>

Consistent with this finding, the Commission adopted a plan to phase-in flat-rated charges for certain access functions so that rates would better reflect ILEC non-traffic-sensitive costs.

However, the Commission retained usage-sensitive charges for traffic-sensitive switching and common transport.<sup>78</sup>

In 1997, the Commission determined that the line cards and dedicated trunk ports in switches were non-traffic-sensitive costs and should be recovered in flat-rated charges. However, because the record did not show that the shared costs of switching were non-traffic-sensitive, the Commission refused to eliminate usage-sensitive charges for shared switching.<sup>79</sup>

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<sup>76</sup> *Intercarrier Compensation NPRM* at ¶ 123.

<sup>77</sup> *MTS and WATS Market Structure*, Third Report and Order, 93 FCC 2d 241 (183) at ¶ 27.

<sup>78</sup> *See Access Charge Reform Order* at ¶¶ 24, 37.

<sup>79</sup> *Id.* at ¶¶ 134-35.

The Commission's *CALLS Order* again preserved usage-sensitive charges for shared local and tandem switching and common transport functions.<sup>80</sup>

The *Intercarrier Compensation NPRM*, however, questions the historical premise that shared switching costs are traffic sensitive.<sup>81</sup> It asks whether flat-rated end-user charges should replace both usage-sensitive local switching and flat-rated PICCs collected from IXC's.<sup>82</sup>

Commenters submit that there is no basis to now reverse this policy and determine that shared local switching costs may be recovered through flat-rated charges. Absent empirical evidence, the Commission has refused to alter its historical classification of switching costs as traffic sensitive.<sup>83</sup> If the Commission were to adopt such a change, in order to be consistent the Commission must require that ILECs recover shared tandem switching costs through a flat-rated charge for IXC's that continue to use ILEC transport to deliver traffic to the central office.

**C. The Commission Would Need to Regulate IXC's**

As noted, bill-and-keep for exchange access would also necessitate the regulation of IXC's. Absent wholesale re-regulation of IXC's, the Commission will not be able to ensure that IXC's pass through any access savings to consumers. For example, although the IXC members of the *CALLS* coalition committed to passing through reductions in access charges,<sup>84</sup> consumer

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<sup>80</sup> See, e.g., *CALLS Order* at ¶ 176.

<sup>81</sup> *Intercarrier Compensation NPRM* at ¶ 123.

<sup>82</sup> *Id.*

<sup>83</sup> See *CALLS Order* at ¶ 134.

<sup>84</sup> *Id.* at ¶ 34.

groups have complained that they have not done so.<sup>85</sup> And the dollar magnitude of the required pass-through would be far greater under bill-and-keep than under CALLS. Adopting bill-and-keep for access could thus force the Commission to consider imposing new regulations on non-dominant carriers. Any such regulations would constitute not only a major policy shift, but also run counter to the deregulatory goals of the Telecom Act.

**D. End User Charges Would Reduce Subscribership**

The Commission should also consider the impact new federally-mandated end user charges could have on customers' subscription decisions. If customers must pay an additional flat rate for the ability to receive long distance calls, even if they do not receive or make many, they might decide connecting to the PSTN is too expensive. Alternatively, if customers must pay additional usage-sensitive rates for receiving long distance calls, they might refuse to make their telephone number available to the public or disconnect their voice mail or answering machine to avoid the costs of unsolicited calls. In short, the new charges could affect not only universal access to telephone service, but also the ability to reach customers that remain on the PSTN. The better approach would be to retain CPNP and set ILEC access charges based on TELRIC.

**E. Bill-and-Keep for Interstate Exchange Access Would Violate Rate Integration Requirements**

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<sup>85</sup> See, e.g., Rick Kelsey, *Feds Rip AT&T for Raising Long-distance Rates* (June 7, 2000) (“‘AT&T promised to pass on savings to all consumers,’ FCC Chairman William E. Kennard said in reference to part of an agreement last week to reduce long-distance access rates by \$3.2 billion. ‘Their new rate plan does not do that. It is in our order and I am going to enforce it.’”) (available at [http://www.info-sec.com/abuse/00/abuse\\_060700a\\_j.shtml](http://www.info-sec.com/abuse/00/abuse_060700a_j.shtml)); *AT&T Raises Basic Rates* (June 1, 2001) (“Consumer groups and rivals seized on the increase to accuse the long-distance company of failing to follow through on a promise to lower rates.”) (available at <http://www.thedigest.com/more/129/129-001.html>).

Adoption of a bill-and-keep regime for access charges would undercut the policies of rate integration and rate averaging codified in Section 254(g) of the Telecom Act. Section 254(g) provides that:

the Commission shall adopt rules to require that the rates charged by providers of interexchange telecommunications services to subscribers in rural and high cost areas shall be no higher than the rates charged by each such provider to its subscribers in urban areas. Such rules shall also require that a provider of interstate interexchange telecommunications services shall provide such services to its subscribers in each State at rates no higher than the rates charged to its subscribers in any other State.<sup>86</sup>

Section 254(g) codified the Commission's pre-existing policies of rate averaging and rate integration.<sup>87</sup> As the Commission observed:

Section 254(g) reflects a congressional determination that the country's higher-cost, lower-volume markets should share in the technological advances and increased competition characteristic of the nation's telecommunication industry as a whole, and that interexchange rates should be provided throughout the nation on a geographically averaged and rate-integrated basis.<sup>88</sup>

A bill-and-keep regime for interstate exchange access would conflict with these policies because it would deaverage access costs because the access cost portion of long distance rates will be recovered by each ILEC from its end users. Thus, bill-and-keep for exchange access would entail subscribers in some states paying more for long distance service because exchange access costs will vary from LEC to LEC. Commenters submit that Section 254(g) prohibits this result.

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<sup>86</sup> 47 U.S.C. § 254(g)

<sup>87</sup> *Policy and Rules Concerning the Interstate, Interexchange Marketplace*, CC Docket No. 96-61, Report and Order, FCC 96-331 (1996) ("*Rate Integration Order*").

<sup>88</sup> *Policy and Rules Concerning the Interstate, Interexchange Marketplace*, CC Docket No. (con't.)

## **VIII. THE OPP PAPERS DO NOT PROVIDE A BASIS FOR ADOPTING BILL-AND-KEEP**

### **A. Assignment of User Benefits Does Not Justify Bill-And-Keep**

The fundamental theoretical premise of both OPP Papers is that intercarrier compensation should no longer be based on the traditional view that the calling party is the cost causer and should, therefore, pay for the call.<sup>89</sup> Instead, according to the OPP Papers, the responsibility for paying for calls should be based on “benefits,” which they view as being shared equally by the calling and called party.

Although the *Intercarrier Compensation NPRM* asked questions as to whether this “benefit” theory supported abandonment of CPNP in favor of bill-and-keep, it is not worth serious consideration.<sup>90</sup> In fact, it is hard to imagine a more unsatisfactory basis for the wholesale shifting of billions of dollars in industry cost recovery from carriers to end users than an evaluation of “benefits” between the calling and the called party. Any evaluation of benefits in this area is unverifiable. It is no accident that the OPP Papers provided no empirical evidence supporting their evaluation of benefits, because none is available. The prospect of the major real world changes contemplated in the *Intercarrier Compensation NPRM* being implemented on the basis of theoretical, unverifiable evaluations of benefits is disconcerting.

Moreover, there is no reason to believe that the OPP Papers are correct in their assignment of benefits between calling and called parties. As explained in the *ETI Report*, it is

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96-61, Memorandum Opinion and Order, FCC 98-347, ¶ 62 (1998).

<sup>89</sup> See *ETI Report* at 44-47.

<sup>90</sup> *Intercarrier Compensation NPRM* at ¶ 37.

more reasonable to assume that the calling party benefits more.<sup>91</sup> Thus, the calling party selects who to call, the time of the call, and the subject of the call. In contrast, the called party does not choose the time of the call, does not know the subject of the call, and does not know what the call will cost. When the call is not answered, or not completed because the line is busy, the called party receives no benefit. And, of course, throwing unsolicited calls into the equation, which would increase under bill-and-keep and which many consumers do not view as conferring any benefit, the more reasonable conclusion is that overall the calling party benefits more. Therefore, even assuming that “benefits” is an appropriate basis for establishing intercarrier compensation schemes, which it is not, there is no reason to accept the conclusions of the OPP Papers in this regard.

However, the OPP Papers also err in assuming that efficient pricing or assignment of responsibility should track benefits of calls. As explained in the *ETI Report*, there is no economic “efficiency” theory requiring that payment responsibility follow benefits.<sup>92</sup> Accordingly, the “benefits” approach of OPP Papers is an unacceptable basis for crafting a new scheme of intercarrier compensation. Since this approach appears to be the theoretical basis for adopting bill-and-keep, the OPP Papers provide no basis for implementing that scheme of intercarrier compensation.

**B. The Suggested Treatments of Transport Costs Would Harm CLECs**

The intercarrier compensation proposals in the OPP Papers should also be rejected because the allocations of transport obligations would be unworkable. In the event that an ILEC

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<sup>91</sup> See *ETI Report* at 46-47.

<sup>92</sup> *Id.* at 47.

and a CLEC were unable to agree on transport obligations, the default rules that would apply under both COBAK and BASICS would harm CLECs by shifting most of the costs of transport to them.

The COBAK proposal simply ignores the fact that CLEC networks may use long-loops or fiber rings in place of the tandem switches deployed by ILECs.<sup>93</sup> Thus, delivery of a call to the CLEC central office may often be the functional equivalent of delivering a call to the ILEC tandem office. Unlike the ILEC that has a relatively short transport obligation after receiving traffic at its end office, the CLEC may have to transport traffic all the way across its network after accepting traffic at its central office. Unless the CLEC were somehow compensated for the use of its long loops or fiber rings, the CLEC would often be undercompensated in a COBAK arrangement. To achieve a level of comparability, the Commission would need to adopt a regime in which the CLEC transport obligation would end at the nearest ILEC tandem office.

Under the BASICS proposal, the new market entrant would be obligated to compensate the ILEC for a share of the incremental costs of interconnection; in other words, the CLEC must pay the ILEC in order to bring the CLEC network up to the ILEC network. The CLEC would be compelled to establish multiple points of interconnection with the incumbent, thereby shifting

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<sup>93</sup> Even though COBAK is founded on the principle that the calling party and the called party share the benefits of a call equally, COBAK departs from this principle with respect to transport. Under COBAK, the originating party pays for all transport to the terminating central office; thus, the cost for the call is borne disproportionately by the calling party. Although the author of COBAK admits that this solution is a pragmatic resolution of allocating transport obligations, this position completely invalidates any theoretical basis for COBAK that assumes both parties benefit equally from a call between them. *ETI Report* at 48.

the transport obligation onto the CLEC for traffic that it originates and terminates.<sup>94</sup> Shifting these costs onto a new market entrant would only make interconnection more expensive, and thereby discourage new market entry.<sup>95</sup>

## **IX. THE COMMISSION SHOULD RETAIN CPNP FOR ALL TRAFFIC**

### **A. CPNP for ISP-Bound Traffic Maximizes Economic Efficiency and Provides ILECs with Proper Incentives**

Instead of establishing bill-and-keep for any category of traffic, the Commission should more thoroughly implement CPNP to address the perceived current “problems.” With respect to ISP-bound traffic, as noted, the *Local Competition Order* established the appropriate framework. There, the Commission correctly determined that symmetrical reciprocal compensation rates would be based on ILEC costs using a forward-looking incremental cost methodology.<sup>96</sup>

As also noted, ILEC unhappiness with this framework is attributable entirely to their own insistence on high reciprocal compensation rates and to the fact they have failed to establish reciprocal compensation rates based on the most efficient technologies available, preferring for the most part simply to retain legacy networks. If ILECs had responded to the strong incentives established by Congress in the reciprocal compensation provision by building the advanced data capabilities envisioned in the Telecom Act, they would not be importuning the Commission to protect them from competition. Thus, instead of bill-and-keep, the Commission should affirm,

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<sup>94</sup> *Id.* at 48-49.

<sup>95</sup> For an overall critique of the OPP Papers, including an analysis of their principal weaknesses, see *ETI Report* at 37-53.

and, to the extent necessary, return to the framework of the *Local Competition Order*. The recent *Collocation Remand Order* may provide guidance to the Commission wherein the Commission determined that in certain respects since the *Local Competition Order* it had overreached.<sup>97</sup>

Assuming *arguendo* that there is a “problem” with intercarrier compensation for ISP-bound traffic, the proposed solution is wrong. In the *ISP Traffic Remand Order*, the Commission suggested that it must abolish intercarrier compensation for ISP-bound calls because “the market distortions caused by applying a CPNP regime to ISP-bound traffic cannot be cured by regulators or carriers simply attempting to ‘get the rate right.’”<sup>98</sup> In the *ISP Traffic Remand Order*, the Commission stated,

Contrary to the view espoused by CLECs, we are concerned that the market distortions caused by applying a CPNP regime to ISP-bound traffic cannot be cured by regulators or carriers simply attempting to “get the rate right.” A few examples may illustrate the vexing problems regulators face. Reciprocal compensation rates have been determined on the basis of the ILEC’s average costs of transport and termination. These rates, do not, therefore reflect the costs incurred by any particular carrier for providing service to a particular customer. This encourages carriers to target customers that are, on average, less costly to serve, and reap a reciprocal compensation windfall.<sup>99</sup>

It is surprising that the *NPRM* would now find intercarrier compensation payments based on average costs so troubling since the Commission has been employing average cost pricing

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<sup>96</sup> *Local Competition Order* at ¶ 1085.

<sup>97</sup> *In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket No. 98-147, Fourth Report and Order (rel. Aug. 8, 2001) (“*Collocation Remand Order*”).

<sup>98</sup> *ISP Traffic Remand Order* at ¶ 76.

since 1934. More importantly, apart from the fact that bill-and-keep for this traffic is unlawful, the *ISP Traffic Remand Order* totally failed to recognize that setting a reciprocal compensation rate based on ILEC average costs provides a level playing field in which both ILECs and CLECs can seek to benefit by becoming more efficient than what is implied in the ILEC rate. As noted in the *ETI Report*, using CLEC costs would produce a skewed result because of the disparity in economies of scale between CLECs and ILECs. Although CLECs have more efficient networks, one can expect CLEC cost studies to generate higher network element rates than those generated by ILEC cost studies.<sup>100</sup>

The approach of the *Local Competition Order* places ILECs and CLECs in exactly the same situation in that both can construct the new networks and facilities that will produce more profits and better service to consumers. In effect, establishing bill-and-keep, as noted, simply rewards ILECs in their status as incumbents by saying that they do not need to construct new networks in order to become more efficient and thereby, to set the groundwork for a lower symmetrical reciprocal compensation rate.<sup>101</sup> In this respect, bill-and-keep insulates ILECs from the competitive pressure that Congress intended in Section 251(b)(5).

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<sup>99</sup> *Id.*

<sup>100</sup> *ETI Report* at 30.

<sup>101</sup> The Commission recognizes that reciprocal compensation rates must keep up with the technology: "We do not suggest that it costs CLECs less to serve ISPs than other types of customers. New switching technologies make it less costly to serve *all* customers. If, however, costs are lower than prevailing reciprocal compensation rates, then CLECs are likely to target customers, such as ISPs, with predominantly incoming traffic, in order to maximize the resulting profit." *ISP Traffic Remand Order* at n.168.

Accordingly, ILECs have a very strong incentive to build more

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In contrast, of course, CLECs do not enjoy the benefits of incumbency. They have gone to the capital markets and have built networks, and some are now facing difficulties because of the risk entailed in doing so. (By contrast, the ILECs faced virtually no investment risk when they built their networks because of their monopoly status and guaranteed rates of return on their investment.) Again, ILECs could have also built new, more efficient networks that could produce the lower reciprocal compensation rates that they would like to impose on CLECs, but they did not, and would prefer that the Commission simply abolish the reciprocal compensation requirement that would otherwise motivate them to do so. ILECs have also preferred to overstate their costs of transport and termination because a realistic assessment of those costs would provide compelling evidence that their interstate and intrastate access charges are grossly inflated. The Commission should not impose a result that harms CLECs because of the questionable business decisions of their incumbent competitors.

In addition, the proposed bill-and-keep solution to the “problem” of intercarrier compensation for ISP-bound calls relies on an assumption that is directly contradicted elsewhere in the *ISP Traffic Remand Order*. This order assumes that there are customers that are “less costly to serve” and that these customers represent a potential windfall to competitors. When one actually considers what carriers are being compensated for when they are paid reciprocal compensation, it is clear that bill-and-keep is not the appropriate solution to the perceived “problem.” Reciprocal compensation is paid for the transport and termination of

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efficient networks – as CLECs have already done – in order to minimize their reciprocal compensation obligations.

telecommunications.<sup>102</sup> Transport is defined as transport from the point-of-interconnection (“POI”) to the terminating carrier’s switch.<sup>103</sup> Termination is defined as the switching function and delivery of the call from the switch to the called party’s premises.<sup>104</sup> Even though the definition suggests that loop costs may be included in the termination function, they are not part of the reciprocal compensation rate that is set using the ILEC’s costs.<sup>105</sup> The Commission explicitly recognizes this point in the *ISP Traffic Remand Order*:

Ameritech maintains that it costs CLECs less to deliver ISP-bound traffic than it costs incumbent LECs to deliver local traffic because CLECs can reduce transmission costs by locating their switches close to ISPs. The proximity of the ISP or other end-user to the delivering carrier’s switch, however, is irrelevant to reciprocal compensation rates. The Commission concluded in the *Local Competition Order* that the non-traffic sensitive cost of the local loop is not an “additional” cost of terminating traffic that a LEC is entitled to recover through reciprocal compensation.<sup>106</sup>

Therefore, a customer can be “less costly to serve” in terms of reciprocal compensation only if there is some aspect of service to that customer that distinguishes the switching function provided to it from that provided to a customer with “average” traffic.

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<sup>102</sup> 47 U.S.C. § 251(b)(5).

<sup>103</sup> 47 CFR §51.701(c).

<sup>104</sup> 47 CFR § 51.701(d).

<sup>105</sup> *Local Competition Order* at ¶ 1057. For this reason, the fact that ISPs may collocate in CLEC central offices is not relevant to whether reciprocal compensation for service to ISPs represents a potential windfall. Whether the length of the facility serving an end user is 100 miles or 100 feet, the cost of that facility is not included in the ILEC-based reciprocal compensation rate paid for transport and termination.

<sup>106</sup> *ISP Traffic Remand Order* at ¶ 92.

In fact, the *ISP Traffic Remand Order* itself confirms “the view espoused by CLECs” that ISPs are not “less costly to serve” than an average end user. According to the Commission,

The record in response to the *Intercarrier Compensation NPRM* and the *Public Notice* fails to establish any inherent differences between the costs on any one network of delivering a voice call to a local end-user and a data call to an ISP. Assuming the two calls have otherwise identical characteristics (e.g., duration and time of day), a LEC generally will incur the same costs when delivering a call to a local end-user as it does delivering a call to an ISP.<sup>107</sup>

Thus, there is no reason to compensate ISP-bound traffic any differently than any other type of traffic.

The rationale in the *NPRM* for adopting bill-and-keep for ISP-bound traffic – namely, that CPNP will allow carriers to reap windfalls because some customers are “less costly to serve” – is completely undermined in the *ISP Traffic Remand Order* by the finding that a correctly devised rate structure eliminates the possibility that some customers are “less costly to serve”:

We are not persuaded by commenters’ claims that the rates for delivery of ISP-bound traffic and local voice traffic should differ because delivering a data call to an ISP is inherently less costly than delivering a voice call to a local end-user. In an attached declaration to Verizon’s comments, William Taylor argues that reciprocal compensation rates may reflect switching costs associated with both originating and terminating functions, despite the fact that ISP traffic generally flows in only one direction. If correct, however, this observation suggests a need to develop rates or rate structures for the transport and termination of *all* traffic that *exclude* costs associated solely with originating switching.<sup>108</sup>

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<sup>107</sup> *Id.* at ¶ 90 (emphasis added).

<sup>108</sup> *Id.* at ¶ 91 (emphasis added).

Thus, the solution is not the adoption of bill-and-keep. Instead, it is the adoption of a rate structure that more accurately reflects the way costs are incurred. The Commission also recognized this principle:

Mr. Taylor similarly argues that ISP-bound calls generally are longer in duration than voice calls, and that a per-minute rate structure applied to calls of longer duration will spread the fixed costs of these calls over more minutes, resulting in lower per-minute costs, and possible over recovery of the fixed costs incurred. Any possibility of over recovery associated with calls (to ISPs or otherwise) of longer than average duration can be eliminated through adoption of rate structures that provide for recovery of per-call costs on a per-call basis, and minute-of-use costs on a minute-of-use basis. We also are not convinced that ISP-bound calls have a lower load distribution (*i.e.*, number and duration of calls in the busy hour as a percent of total traffic), and that these calls therefore impose lower additional costs on a network. It is not clear from the record that there is any "basis to speculate that the busy hour for calls to ISPs will be different than the CLEC switch busy hour," especially when the busy hour is determined by the flow of both voice and data traffic.<sup>109</sup>

Thus, it could not be clearer that the *NPRM*'s premise that bill-and-keep is necessary to avoid the ability of carriers to "reap a reciprocal compensation windfall" is incorrect.

The Texas Public Utility Commission has also considered the issue of whether it is less costly to serve ISPs. It concluded that ISPs are not necessarily less costly to serve for the purposes of reciprocal compensation.<sup>110</sup> In framing the issue, the Texas PUC stated, "SWBT notes that a principal reason that it is less costly to terminate an ISP-bound call than a voice call

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<sup>109</sup> *Id.* (emphasis added)

<sup>110</sup> *Proceeding to Examine Reciprocal Compensation Pursuant to Section 252 of the Federal Telecommunications Act of 1996*, Docket No. 21982, Arbitration Award (Tex. PUC July 13, 2000) at 47.

is the longer average hold time.”<sup>111</sup> According to SWBT, the average duration of a voice call was 3 minutes in its cost study, but the average duration of an ISP-bound call was 29 minutes. The longer duration of the ISP-bound call requires far fewer call set-up and call tear-down costs than were factored into the Texas reciprocal compensation rate.<sup>112</sup> This was remedied by the Texas PUC by bifurcating the reciprocal compensation rate into a per-call set-up charge and a per-minute duration charge. The Texas PUC was thereby able to eliminate whatever economic distortions may have occurred as a result of the longer duration of ISP-bound calls. In any event, this approach disproves the assumption in the *NPRM* and in the *ISP Traffic Remand Order* that the variability inherent in service to a subsection of end users justifies eliminating the CPNP regime and adopting bill-and-keep.<sup>113</sup>

The *ISP Traffic Remand Order* also suggests that bill-and-keep is necessary to avoid a flight of CLECs to those customers “less costly to serve” and implies that an individual carrier’s costs must be determined if regulators are to get the rate right.<sup>114</sup> The Commission cited the impracticality of such a proposal as a justification for imposing bill-and-keep on the transport

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<sup>111</sup> *Id.* at 43.

<sup>112</sup> *Id.*

<sup>113</sup> Throughout its 13-state service territory, SBC apparently has subscribed to the idea that a bifurcated reciprocal compensation rate remedies whatever economic distortions may exist as a result of the payment of reciprocal compensation. In its new “Reciprocal Compensation Appendix” to its interconnection agreement template, SBC elects not to adopt the federal intercarrier compensation regime for ISP-bound traffic. Instead, SBC offers to pay a bifurcated reciprocal compensation rate for all traffic, including ISP-bound traffic. The Reciprocal Compensation Appendix is available at <https://clec.sbc.com/unrestr/interconnect/multi/index.cfm>.

<sup>114</sup> *ISP Traffic Remand Order* at ¶ 76.

and termination of ISP-bound traffic.<sup>115</sup> In fact, it is not necessary to consider each and every individual carrier's costs in order to establish reasonable terminating compensation rates that eliminate so-called market distortions. As noted, rates based on ILEC costs will provide an incentive to ILECs to build more efficient networks in order to reduce their reciprocal compensation obligations. This approach, if the Commission would stick with it, would provide the best way to address any concerns about cost-based rates for reciprocal compensation.

In short, bill-and-keep is the entirely wrong solution to the "problem" of intercarrier compensation for ISP-bound traffic that the *NPRM* perceives. Instead of the strained interpretations of the Telecom Act, such as the recent finding that ISP-bound traffic constitutes "information access" that attempts to rewrite Section 251(b)(5), the Commission should fully embrace the framework of the *Local Competition Order*. For all the reasons stated herein, this would best produce the competitive environment Congress intended in the Telecom Act.

**B. The Commission Should Not Mandate Interconnection In Each ILEC-Defined Local Calling Area**

**1. The Commission Should Retain the Single-POI-per-LATA Requirement**

The proposals to implement bill-and-keep should also be rejected because they would apparently mandate inefficient interconnection requirements. The Commission should retain the current rule that permits a CLEC to designate a single point in each LATA to interconnect with the incumbent while permitting carriers to negotiate additional POIs based upon sound engineering principles and traffic volumes.

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<sup>115</sup> *Id.* at ¶ 76.

When transport was more expensive than it is now and switches had less capacity than they do now, carriers would deploy multiple switches within a particular geographic region. Switches would be connected to each other through tandem switches. The telecommunications network largely assumed a hub-and-spoke architecture in which the tandem switches were the hubs and the end offices were at the ends of the interoffice transport “spokes.” At the time, this was the most efficient way to provide ubiquitous coverage and interconnectivity. For the purposes of this description, we can assume that a single tandem-to-end-offices hub-and-spoke arrangement would cover a single ILEC-defined local calling area, and a call that involved transport between tandem switches would qualify as a toll call.

With the advent of fiber optic technologies, however, transport costs have been dramatically reduced. Further, switching technology has become more efficient. As a result, a single switch connected to fiber-optic transport can serve geographic areas comparable to the areas previously served by tandem switches connected to end-office switches. For example, by deploying fiber-optic transport in a ring around a large geographic area, with its switch on one point on the ring and the POI with the ILEC on another point on the ring, a CLEC can serve multiple ILEC-defined local calling areas from a single switch.<sup>116</sup> Customers throughout the area served by the ring can obtain service from the CLEC by being connected to the ring, and any traffic carried over the ring can be handed over to the ILEC at the POI for termination on the ILEC network.

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<sup>116</sup> Obviously, this more advanced technology further blurs the distinction between local traffic and toll traffic. *See* discussion *supra*, Section IV.D.

However, under the bill-and-keep proposals being considered by the Commission, CLECs would be required to abandon their efficient network by establishing POIs in each ILEC-defined local calling area. CLECs can service customers efficiently without deploying multiple switches or POIs across a wide geographic area, and should not be required to do so. Thus, like the other proposals in the *NPRM*, CLECs would be penalized for their success in building efficient networks by making them mimic ILEC networks and calling areas. In fact, as discussed in the *ETI Report*, there is no economic or other basis for making CLECs duplicate ILEC-defined local calling areas.<sup>117</sup> Accordingly, the Commission should not require CLECs to interconnect in each ILEC-defined local calling area, and the rule permitting a single POI per LATA should be retained. The better approach is to leave interconnection arrangements to negotiation between the parties, based on sound engineering principles subject to the single-POI-per-LATA default rule.

**2. The Use of Virtual Central Office Codes by CLECs Does Not Justify Requiring More Than One Interconnection Point per LATA**

The use of virtual central office codes (NXX codes) by CLECs appears to be the primary motivating factor for possible revision of the single POI requirement. The practice of using central office codes to serve customers that are not physically located in the ILEC-defined local calling area associated with the central office code is an unexceptional practice. ILECs have provided “foreign exchange” services for years. CLEC use of virtual central office codes is a competitive response to ILEC practices.

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<sup>117</sup> *ETI Report* at 49-53.

CLECs serving ISPs began implementing virtual NXX services in response to Bell Atlantic's provision of a product called Wide Area FlexPath, Ameritech's provision of a service called Ensemble or OmniPresence, and now Verizon's CyberPOP service.<sup>118</sup> Wide Area FlexPath is a service offered to ISPs by the Bell Atlantic Verizon companies that allows ISPs to establish a single physical location to terminate inbound dial-up traffic, but provides them with telephone numbers located throughout Bell Atlantic's service territory. End users can place calls to the ISP that are rated as local calls even though the ISP's modem facilities are located in another local calling area. The same is true for the Ensemble/OmniPresence and CyberPOP products. Competitive necessity required CLECs serving ISPs to make a comparable virtual NXX service available. This was accomplished by obtaining NXX codes for ILEC-defined local calling areas to allow their ISP customers to establish a "virtual" local presence there. (The presence is "virtual" insofar as one believes that CLECs must adhere to the local calling areas

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<sup>118</sup> *Investigation into the Acquisition and Use of Central Office Codes by Local Exchange Carriers in Vermont*, Docket No. 6209, Order Opening Investigation and Notice of Hearing (Vt. Pub. Svc. Bd. Mar. 25, 1999); <http://www.ameritech.com/ucontent/1,4674,278,00.html> ("OmniPresence uses the Ameritech network to provide a virtual presence in multiple locations for your business. For example, you are located in Chicago but want to provide local telephone numbers to locations outside the city so customers can call without incurring local toll charges. OmniPresence allows you to provide local numbers without having to invest in space or equipment at each dial-up location."); <http://www.sbc.com/ISP/0,2951,9,00.html> ("ENSEMBLE is a single Point-of-Presence (POP) solution that allows you to provide your customers with local access within the Ameritech-served areas of a specific LATA. You can set up dial-up phone numbers for your subscribers within a designated LATA using a single POP. Without the need for multiple POPs, your cost savings will grow."); <http://www22.verizon.com/wholesale/attachments/5924D.PDF> ("Addressing the challenge of connecting subscribers to the Internet using local connections, Verizon's CyberPOP platform gives ISPs points-of-presence in Verizon Central Offices to provide a fast, cost-effective means for meeting the growing demands in your service areas. Expanding into new markets for increased profitability and a broader reach goes from possible to probable, because CyberPOP leverages Verizon's national footprint to build your presence in the marketplace without your  
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defined by the ILECs.) Calls placed to those numbers are rated by the ILEC as local calls, exchanged with the CLEC at the POI, and terminated at the ISP by the CLEC. As local calls, they also are subject to reciprocal compensation under the interconnection agreements between the ILEC and the CLEC.

It is important to note that the originating carrier's switching and transport obligation is the same whether or not virtual central office codes are used by the terminating carrier. Since the originating carrier is required to switch and transport all traffic to the POI with the terminating carrier, the physical location of the terminating carrier's customer has no relevance to the level of transport the originating carrier must provide to complete the call. For this reason, the originating carrier should be completely indifferent as to where the terminating carrier's customer is located. Therefore, it makes no sense to require the terminating carrier to establish a POI in every ILEC-defined local calling area where it has an NXX code homed.

Further, the entire discussion of the use of "virtual central office codes" begins from the questionable premise that CLECs must follow ILEC-defined local calling areas in the provision of their own competitive services. As discussed above, ILEC-defined local calling areas are an anachronism that is neither required nor appropriate in the contemporary telecommunications market.<sup>119</sup> Just as it makes no sense now to require carriers to establish interconnection arrangements on the basis of an essentially outmoded distinction between local traffic and toll traffic,<sup>120</sup> the idea that CLEC customers must establish "virtual" a presence anywhere is equally

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having to own or maintain equipment and staff a new facility.")

<sup>119</sup> *ETI Report* at 52.

<sup>120</sup> *Id.* at 50-53.

anachronistic. CLECs should be allowed to define the boundaries of calling areas in which inbound calls would be rated as local just as much as they define boundaries of calling areas in which outbound calls are rated as local.<sup>121</sup> Thus, there should be no change to the existing requirement that a CLEC must establish only a single POI per LATA. The rule provides an excellent baseline from which carriers may negotiate alternate transport arrangements based upon sound engineering and economic principles.

**3. Intercarrier Compensation For Transport And Termination Of Virtual Central Office Code Traffic To ISPs Is Governed By The *ISP Traffic Remand Order*.**

If the Commission correctly determines not to adopt the bill-and-keep proposals that would require CLECs to establish multiple points of interconnection with the ILEC, the Commission need go no further than ruling that it will retain the requirement that a CLEC may designate a single POI per LATA with the incumbent. To the extent that the Commission addresses the interconnection and transport issues any further in this proceeding, it must make clear that these issues are governed by sections 251(a), (b) and (c) of the Telecom Act, and are unrelated to Section 251(b)(5) reciprocal compensation or so-called Section 251(g) “information access” intercarrier compensation.

In any event, the issue of intercarrier compensation for the transport and termination of traffic to ISPs using virtual central office codes is governed by the terms of the *ISP Traffic Remand Order*. The Commission did not distinguish between types of ISP-bound traffic, but instead ruled that all ISP-bound “information access” traffic is subject to the federal regime established in that Order. Therefore, with respect to intercarrier compensation for the transport

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<sup>121</sup> *Id.* at 51.

and termination of ISP-bound traffic, it makes no difference whether a terminating carrier uses virtual central office codes to provide service. All ISP-bound information access traffic is compensated at the applicable rates under the federal regime in the *ISP Traffic Remand Order*, and the *NPRM* provides no reason to vary from that result for virtual central office code traffic.

**C. The Commission Should Reject Arbitrary Traffic-Exchange Ratios in a CPNP Regime**

In the *ISP Traffic Remand Order*, the Commission adopted a compensation regime in which, once a terminating carrier's traffic volume exceeds a fixed 3:1 ratio of outbound calls to inbound calls, the terminating carrier would be paid at a rate significantly lower than state-approved rates for reciprocal compensation based on ILEC costs.<sup>122</sup> Going forward, the Commission should reject such arbitrary thresholds because they are *per se* discriminatory against carriers that serve customers with predominantly inbound traffic, and they have no sound economic justification.<sup>123</sup> These arrangements serve only to limit the amount of terminating compensation a carrier may receive, without regard to whether the above-ratio rate reflects the costs incurred by the terminating carrier. They also inappropriately assume that unbalanced traffic flows should be discouraged, and should be corrected through regulatory dictates.<sup>124</sup> Because there is no principled reason to impose such restrictions on terminating compensation, compensation thresholds based upon traffic-exchange ratios should be rejected.

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<sup>122</sup> *ISP Traffic Remand Order* at ¶ 79.

<sup>123</sup> *ETI Report* at 54-59.

<sup>124</sup> *Id.* at 59.

## **X. CONCLUSION**

The so-called “problems” that the *Intercarrier Compensation NPRM* purports to fix are in fact little more than nascent competition in action. The Commission established a set of ground rules in the *Local Competition Order* to handle these new markets that the Commission need not second-guess. Chief among these ground rules was the proper conclusion that bill-and-keep may not be imposed between two carriers unless traffic exchanged between them is roughly in balance. The Commission was right then, and there is no need to revisit that conclusion. When more thoroughly implemented, that is, when terminating compensation rates (for both exchange access and telephone exchange service, including ISP-bound traffic) are set at the forward-looking economic cost of the ILEC, the rules from the *Local Competition Order* will resolve any short-term problems related to intercarrier compensation. The negative consequences and impracticality of the alternative are so overwhelming as to require the immediate rejection of mandatory bill-and-keep. The complete upheaval of industry practice, as well as the shifting of billions of dollars in cost recovery from carriers to end users, should not be seriously considered. For the reasons stated herein, the proposals in the *NPRM* to adopt a bill-and-keep regime as the basis for intercarrier compensation should be abandoned.

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